

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Gatto, Bocanegra, et al. Analyst: Jane Raboy Bill Number: AB 1839  
Related Bills: See Legislative History Telephone: 845-5718 Introduced Date: February 18, 2014  
Amended Date: March 19, 2014  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** California Qualified Motion Picture Production Credit

### SUMMARY

This bill would create a credit for the production of a qualified motion picture (New Motion Picture Credit) under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

### RECOMMENDATION

No position.

### SUMMARY OF AMENDMENTS

As introduced on February 18, 2014, this bill would create a New Motion Picture Credit and would authorize the California Film Commission (Commission) to administer the credit, allocate tax credits, and establish program guidelines, application, and certification procedures.

The March 19, 2014, amendments added several co-authors, made several substantive and technical changes, and modified the responsibilities of the Commission.

This is the department's first analysis of the bill.

### REASON FOR THE BILL

The reason for this bill is to expand and improve in-state competitiveness by retaining film and television productions in California.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative as follows:

- Tax credits would be allowed for taxable years beginning on or after January 1, 2016.
- Tax credits would be allocated by the Commission on or after July 1, 2016, and before July 1, 2021.

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## **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.

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.

### FEDERAL LAW

Federal law does not allow any credit for motion picture productions.

### STATE LAW

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; or
- A television series that relocates to California with no minimum budget and is produced for any media outlet.

The Commission administers the existing motion picture credit (Original 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 (LAO), and the Board of Equalization (BOE) a list of the taxpayers and the tax credit amounts allocated to each taxpayer by the Commission.

A qualified taxpayer may sell the Original Motion Picture Credit, 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.

The Original Motion Picture Credit 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

For taxable years beginning on or after January 1, 2016, this bill would allow a qualified taxpayer, as defined, a New Motion Picture Credit equal to an applicable percentage, as specified, of the qualified expenditures for the production of a qualified motion picture, as defined, in California.

The applicable percentage would be:

- 20 percent of qualified expenditures, as defined, attributable to either:
  - the production of a qualified motion picture in California, including, but not limited to, a feature, up to \$100 million dollars, or
  - a television series in its second or subsequent year of receiving a tax credit allocation.
- 25 percent of qualified expenditures, as defined, attributable to the production of either:
  - a qualified motion picture where the qualified motion picture is a television series that relocated to California in its first year of receiving tax credit allocation under this provision, or
  - an independent film, as defined.
- 25 percent of qualified expenditures, as defined, relating to music scoring and music editing attributable to the production of a qualified motion picture in California.

The applicable percentage would be increased by 5 percent, not to exceed a maximum of 25 percent, if the qualified motion picture incurred or paid the qualified expenditures relating to original photography outside the Los Angeles zone.

This bill would prohibit a credit for any qualified expenditures for the production of a motion picture in California, if a credit for those same expenditures has been claimed under the Original Motion Picture Credit.<sup>1</sup>

The Commission would be required to allocate credits on or after July 1, 2016, and before July 1, 2021, and the amount of the credit allowed to a qualified taxpayer would be limited to the amount specified in the credit certificate issued by the Commission.

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

- The \_\_\_\_\_ amount for the 2016/2017 fiscal year and each fiscal year thereafter, through and including the 2020/2021 fiscal year.
- The unused allocation credit amount, if any, for the preceding fiscal year.
- The amount of previously allocated credit not certified.

For pass-thru entities<sup>2</sup>, a "qualified taxpayer" determination would be made at the entity level and the credit would not be allowed to the pass thru (including an S corporation with respect to the tax imposed on S corporations under Part 11) but passed through to the entity's partners or shareholders.

A qualified taxpayer may sell any credit allowed that is attributable to an independent film to an unrelated party, as defined. The qualified taxpayer would be required to report prior to the sale of the credit, all required information regarding the purchase and sale of the credit, in a form and manner specified by the FTB.

A qualified taxpayer would be prohibited from assigning or selling any tax credit to the extent the tax credit allowed is claimed on any tax return of the qualified taxpayer. In the event more than one taxpayer claims the same credit allocated by the Commission, the FTB could disallow the credit of either taxpayer if the statute of limitations remains open. An unrelated party or party that purchases a credit would be treated as a qualified taxpayer and subject to the requirements of this bill.

Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability could be carried over for six years, if necessary, until the credit has been exhausted.

This bill would exempt the FTB's standards, criteria, procedures, determinations, rules, notices, or guidelines from the requirements of the Administrative Procedures Act.<sup>3</sup>

In the event that a qualified taxpayer fails to provide the copyright registration number as required, the credit would be disallowed and assessed, and collected until the requirements are satisfied. A disallowed credit would be treated as a math error.<sup>4</sup>

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<sup>1</sup> Pursuant to Revenue and Taxation Code Section (R&TC) 17053.85 although incorrectly referenced to R&TC Section 23695.

<sup>2</sup> "Pass-thru entity" means any entity taxed as a partnership or S corporation.

<sup>3</sup> Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

<sup>4</sup> A math error appearing on the return results in an assessment that is due and payable on notice and demand instead of by a notice of proposed assessment with prepayment protest rights that generally is issued after an audit pursuant to R&TC Section 19051.

Annually, the Commission would be required to provide the LAO, the FTB, and the BOE with a list of qualified taxpayers and the tax credit amounts allocated to each qualified taxpayer by the Commission. The FTB would be required to accept the tax credit amounts as reported on the Commission's listing.

This bill would define the following terms and phrases: "applicable period," "ancillary product," "budget," "clip use," "credit certificate," "employee fringe benefits," "independent film," "licensing," "Los Angeles zone," "new use," "original photography," "post production," "preproduction," "principal photography," "production period," "qualified entity," "qualified individual," "qualified motion picture," "qualified expenditures," "qualified expenditures relating to original photography outside the Los Angeles zone," "qualified taxpayer," "qualified wages," "residual compensation," "reuse," "secondary markets," "television series that relocated to California," and "pilot for a new television series." These terms or phrases would have no impact on the FTB's duties.

Under the CTL, where the credit allowed exceeds the taxpayer's tax liability, a qualified taxpayer may elect to make an irrevocable assignment of any portion of the credit allowed to one or more affiliated corporations,<sup>5</sup> as defined, for each taxable year the credit is allowed. The election may be based on any method selected by the qualified taxpayer that originally receives the credit, changed for any subsequent taxable year if the election to make the assignment is expressly shown on each of the returns of the qualified taxpayer and the qualified taxpayer's affiliated corporations that assign and receive the credits and must be reported to the FTB, along with all required information regarding the assignment of the credit, as specified.

This bill would treat an affiliated corporation or corporations, unrelated party or parties that are assigned a credit, as a qualified taxpayer.

The provisions of this bill would be severable, so that if any provision or its application is held invalid, that invalidity would not affect other provisions or applications that can still be given effect absent the invalidated provision or application.

### IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems.

### TECHNICAL CONSIDERATIONS

Page 3, line 37, needs to be amended where the term "pre production" appears, as it should be "preproduction" to correspond to page 5, line 27.

Page 3, lines 32 through 34, on page 16, lines 23 through 25, is awkwardly worded. Revise to read, "if qualified expenditures relating to original photography were paid or incurred for tangible personal property used and services performed outside the Los Angeles zone."

Page 17, line 33, needs to be amended where the term "soundmixing" appears, as it should be "sound mixing" to correspond to page 5, line 23.

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<sup>5</sup> R&TC Section 25110(b).

Page 11, line 16, the word, "and" the first place it appears is unnecessary and should be deleted.

Page 15, line 34, "Section 23695" should read "Section 23685" to correct for a typographical error.

## LEGISLATIVE HISTORY

AB 286 (Nazarian, 2013/2014) would modify the existing Motion Picture Credit. AB 286 is currently held at desk in the Assembly.

AB 1189 (Nazarian, 2013/2014) would extend the Commission's authority to allocate and certify the Original 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. AB 1189 is currently held at desk in the Assembly.

AB 2026 (Fuentes, Chapter 841, Statutes of 2012) extended the Commission's authority to allocate and certify the Original 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 Original 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 Original Motion Picture Credit and required the Commission to administer the Original Motion Picture Credit's allocation and certification program.

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

SB 1197 (Calderon, 2009/2010) would extend, for two additional years, until July 1, 2017, the California Motion Picture Credit. 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.

*Florida* created a five-year \$296 million transferable corporate income tax credit incentive program for the film and entertainment industry. The program began on July 1, 2010, and sunsets June 30, 2016. Generally, the credits are 20 percent of qualified expenditures, with additional amounts available under certain circumstances.

*Illinois* offers a nonrefundable film production services credit equal to 30 percent of all qualified expenditures, including post-production, and includes an additional 15 percent film production services credit for salaries for individuals living in an economically disadvantaged area. The state's credit only applies to residents' wages, limited to \$100,000, and will sunset in 2021. Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability is carried forward up to five years.

*Massachusetts* allows two motion picture production income tax credits for taxable years beginning on or after January 1, 2006 and before January 1, 2023. *Massachusetts* allows a transferable 25 percent payroll credit on aggregate payroll that is subject to s personal income tax withholding. There is also a transferable 25 percent qualified production expense credit for production companies. A tax liability is credited to the company's personal income or corporate excise tax liability and the tax credits may be transferred or the credits may be refunded by the state for 90 percent of their value. If transferred, tax credits can be carried forward five years.

*Michigan* imposes a corporate income tax that replaced the Michigan Business Tax for most taxpayers, effective January 1, 2012. Currently, the new corporate income tax does not provide for credits for qualified production companies, film and digital media infrastructure investments, or film/television job training expenditures.

*Minnesota* does not allow any motion picture tax credit or motion picture incentives against the corporate income tax.

*New York* offers a NY State Film Production Credit that is refundable and equal to 30 percent of qualified costs incurred in New York State. The funding allocated to the program totals \$420 million per year for calendar years 2010 through 2014, inclusive. \$7 million per year, of the total amount is reserved for The New York State Post Production Credit.

## **FISCAL IMPACT**

This bill would create a New Motion Picture Credit and require a new form or worksheet to be developed. As a result, this bill would impact the department's printing, processing, and systems modifications costs. The additional costs will be developed as the bill moves through the legislative process.

## **ECONOMIC IMPACT**

The bill would establish a New Motion Picture Credit under the PITL and CTL, but fails to specify the aggregate amount of the credits that may be allocated. Absent this information, the FTB has insufficient information to complete a revenue estimate.

## **LEGAL IMPACT**

The Motion Picture Credit 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., 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 supporters may argue that additional incentives are needed to expand and improve state competitiveness in attracting and retaining motion picture production activity.

Opponents: Some have questioned whether motion picture credits have an appreciable long-term benefit to the state.

## **POLICY CONCERNS**

This bill would provide an additional 5 percent applicable percentage if a qualified taxpayer incurred or paid qualified expenditures relating to original photography outside the Los Angeles zone but fails to provide a quantitative measure of qualified expenditures. It is possible that a taxpayer could perform one day of original photography outside the Los Angeles zone and increase the applicable percentage by 5 percent for all qualified expenditures. If this bill were to provide a quantitative measure of qualified expenditures this potential problem would be avoided.

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