Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Lieu	Analyst:	Jane Raboy	Bill Number:	SB 370
Related Bills:	See Legislative History	Telephone:	845-5718	Amended Date:	January 22, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Qualified Commercial Production Credit

SUMMARY

This bill would create two tax credits for the production of commercials under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

RECOMMENDATION

No position.

Summary of Amendments

The January 22, 2014, amendments removed the appropriation language, added tax levy language, modified the bill's operative dates, replaced the provisions allowing excess credits to be refunded with provisions allowing the sale of credits to an unrelated party, modified the definition of qualified commercial, and made several nonsubstantive changes.

The January 22, 2014, amendments resolved several, but not all, of the implementation, technical, and policy concerns discussed in the department's analysis of the bill as amended July 3, 2013, and raised additional implementation and technical concerns. As a result of the amendments, this analysis replaces the department's analysis of the bill as amended July 3, 2013.

REASON FOR THE BILL

The reason for this bill is to encourage commercial production within the state by providing tax credits that would operate similar to the California Film & Television Tax Credit (Motion Picture Credit).

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2015.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

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 does not allow any credit for motion picture or commercial productions.

Motion Picture Credit

For taxable years beginning on or after January 1, 2011, a qualified taxpayer is allowed a Motion Picture Credit nonrefundable credit or a credit against the qualified sales and use tax.

The tax credit to a qualified taxpayer is for 20 percent of qualified expenditures, attributable to the production of a qualified motion picture, and 25 percent of qualified expenditures, attributable to the production of a qualified motion picture where the motion picture is a television series relocated to California or an independent film, in California.[1]

This credit is allocated in the fiscal year that the production begins and is certified by the California Film Commission after the production is completed.

A qualified taxpayer may, in lieu of claiming the credit, make an irrevocable election to apply the credit amount against qualified sales and use taxes imposed on the qualified taxpayer.

This credit specifically overrides the credit usage limitation rules for credits earned by disregarded entities.

Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability can be taken over a period of six taxable years or until the credit is exhausted, whichever occurs first.

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.

Assignment of Credits between Certain Unitary Affiliates

Corporate taxpayers who are members of a combined reporting group may make a one time, irrevocable assignment of earned tax credits to certain assignees eligible credits, as defined, to an eligible assignee, as defined, in taxable years beginning on or after July 1, 2008. Assigned credits can reduce tax for taxable years beginning on or after January 1, 2010.[2]

[1] Revenue and Taxation Code sections 17053.85 and 23685.
[2] Revenue and Taxation Code section 23663.

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2015, this bill would create two tax credits, within the studio zone (Studio Zone Credit) and outside the studio zone and within the state (Outside the Studio Zone Credit) for the production of a qualified commercial, as defined, by a qualified taxpayer, as defined.

The California Film Commission (Commission) would have the authority to allocate and certify an amount of credit for both the Studio Zone Credit and the Outside the Studio Zone Credit. In addition, the Commission would be required to provide annually to the Legislative Analyst's Office and the Franchise Tax Board (FTB) an approved list of tax credit amounts allocated to each qualified taxpayer.

Under the CTL, all members of a commonly controlled group would be treated as a single qualified taxpayer for the purposes of computing qualified expenditures.

A "qualified taxpayer" determination would be made at the entity level and the credit would be passed through to the partners or shareholders of the pass-through entity level.

This bill would allow a qualified taxpayer to carry over any credits not used in the taxable year for up to seven taxable years, or make a one-time sale of the unused credits to an unrelated party.

Prior to the sale of a credit a qualified taxpayer would report to the FTB all required information on the purchase and sale of the credit, including the social security number or other taxpayer identification number, the face amount of the credit sold, and the amount of the consideration received by the qualifying taxpayer for the sale of the credit.

An unrelated party would be prohibited from reselling a credit and a qualified taxpayer would be prohibited from assigning or selling a credit already claimed on the qualified taxpayer's tax return.

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.

The credits would be in lieu of any credit otherwise allowable with respect to the qualified expenditures.

1. Studio Zone Credit

The Studio Zone Credit would be equal to 15 percent of a qualified taxpayer's qualified expenditures credit base for the production of a qualified commercial within the studio zone.

The aggregate amount of credits that may be allocated ("Total Authorized Credit") in any fiscal year would be equal to the following:

- $13 million in credits in the 2014-15 fiscal year, and each fiscal year thereafter; plus,
- Any unused allocated credit amount, if any, from the prior fiscal year.

If the amount of credits applied for in any particular fiscal year exceeds the “Total Authorized Credit,” the aggregate amount of credits would be allocated to each qualified taxpayer on a pro-rata basis.

If the amount of credits allocated in a fiscal year is less than the “Total Authorized Credit” for qualified commercials within the studio zone, the remaining amount would be allocated to qualified taxpayers outside of the studio zone and within the state on a pro-rata basis, limited to 15 percent of the amount of the qualified expenditures credit base.

Defined Terms for the Studio Zone Credit

“Studio zone” would mean the area within a circle of 30 miles in radius from the intersection of Beverly Boulevard and La Cienega Boulevard in Los Angeles, California.

“Qualified expenditures credit base” would mean the amount over $500,000 paid or incurred during the taxable year within the studio zone in qualified expenditures.

“Qualified expenditures” would mean the amount paid or incurred during the taxable year to purchase or lease tangible personal property within the studio zone in the production of a qualified commercial, and to pay for services performed within the studio zone in the production of a qualified commercial.

“Qualified taxpayer” would mean a taxpayer that is principally engaged in the production of a qualified commercial, has control over the management of the production, and has paid or incurred at least $500,000 in qualified expenditures within the studio zone during the taxable year.

2. Outside the Studio Zone Credit

The Outside the Studio Zone Credit would be equal to 15 percent of a qualified taxpayer’s qualified expenditures credit base for the production of a qualified commercial outside the studio zone and within the state.

The “Total Authorized Credit” in any fiscal year would be equal to the following:

- $2 million in credits for the 2014-15 fiscal year, and each fiscal year thereafter; plus,
- Any unused allocated credit amount, if any, from the prior fiscal year.

If the amount of credits applied for in any particular fiscal year exceeds the “Total Authorized Credit,” the aggregate amount of credits would be allocated to each qualified taxpayer on a pro rata basis.

If the amount of credits allocated in a fiscal year is less than the “Total Authorized Credit” for qualified commercials outside the studio zone and within the state, the remaining amount would be allocated to qualified taxpayers within the studio zone on a pro-rata basis, limited to 15 percent of the amount of the qualified expenditures credit base.

Defined Terms for Outside the Studio Zone Credit

“Qualified expenditures credit base” would mean the amount over $250,000 paid or incurred during the taxable year outside of the studio zone in qualified expenditures.

“Qualified expenditures” would mean the amount paid or incurred during the taxable year to purchase or lease tangible personal property outside of the studio zone and within the state in the production of a qualified commercial, and to pay for services performed outside of the studio zone and within the state in the production of a qualified commercial.

“Qualified taxpayer” would mean a taxpayer that is principally engaged in the production of a qualified commercial, has control over the management of the production, and paid or incurred at least $250,000 in qualified expenditures outside of the studio zone and within the state during the taxable year.

The bill would define the following terms for both tax credits: “employee fringe benefits,” “qualified commercial,” “qualified individual,” “qualified wages,” and “pass-thru entity.”

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill uses phrases that are undefined, i.e., “credit certificate” and “qualified entity.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

It is unclear whether the Commission’s reallocation of under allocated credit amounts would be limited to 15 percent of the amount of the qualified expenditure credit base in the amount over $500,000 or over $250,000 in qualified expenditures. The author may wish to amend this bill for clarity.

TECHNICAL CONSIDERATIONS

On page 4, line 36, page 18, line 24, and page 25, line 22, the phrase “qualified taxpayer” should read “qualified entity” for consistent use of terminology and internal harmony. As stated under “Implementation Considerations,” the phrase “qualified entity” requires a definition.

On page 5, line 27, page 12, line 21, page 19, line 15, and page 26, line 15, the phrase "a qualified taxpayer may do either of the following" should be added after "Notwithstanding any other law," for clarification.

On page 5, line 38, page 12, line 32, page 19, line 26, and page 26, line 26, the phrase "unrelated party" should read "taxpayer," for consistent use of terminology with the Motion Picture Credit.

On page 6, line 1, page 12, line 34, page 19, line 28, and page 26, line 28, the phrase "An unrelated" should read "A party," because a qualified taxpayer or an unrelated party would be subject to the same requirements under the sections.

On page 8, line 25, the word “both” should read “all.” Although the reference of "both" is for two subparagraphs the use of "all" is consistent with the wording on page 15, line 17, page 22, line 11, and page 29, line 11.

On page 8, lines 38-39, the phrase “outside of the studio zone and within the state” is redundant and should be deleted.

On page 10, line 34, the phrase “outside the studio” should read “outside of the studio” for consistent use of terminology.

On page 13, line 36, page 20, line 30, and page 27, line 30, the phrase “identified in or required to implement” should read “identified in, or required to, implement”.

On page 18, lines 15 and16 and page 25, lines 13 and14 the phrase “Chapter 4.5 (commencing with Section 23800) of Part 11 of Division 2.” should read “this part.”

LEGISLATIVE HISTORY

SB 740 (Calderon, 2007/2008) would have created a transferable income and franchise tax credit based on wages paid and property used in connection with a qualified production made in California. SB 740 failed to pass out of the house of origin by the constitutional deadline.

AB 777 (Nunez, 2005/2006) would have created refundable credits based on amounts paid for wages or the purchase or lease of certain property used to produce motion pictures or commercials in California. AB 777 was held in the Assembly Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

The states surveyed 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 tax credit incentive program for the film and entertainment industry. The priority for qualifying and certifying projects for tax credit awards is determined on first-come, first-served basis within its appropriate queue. After a production company produces national or regional commercials, music videos, or both, and reaches the threshold of $500,000 within a fiscal year, it is eligible to apply for a maximum incentive award of $500,000 per fiscal year.

Illinois offers a nonrefundable film production services credit equal to 30 percent of all qualified expenditures, including post-production. As a commercial production, the taxpayer must spend $50,000 on a project to qualify (including pre- and post-production costs).

Massachusetts allows two income tax credits for motion picture production companies that are produced in-state during a 12-month period. *Massachusetts* defines film production company as a company engaged in the business of producing motion pictures, videos, television series, or commercials intended for theatrical release or for television reviewing. Effective 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 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 5 years.

Michigan and *Minnesota* do not allow a commercial production tax credit or motion picture incentives against the corporate income tax.

New York allows a refundable Empire state commercial production tax credit for qualified commercial production companies shooting commercials within the state. There are three component credit programs: an Upstate program, a Downstate program, and a Growth program. In the Upstate and Downstate programs, after meeting certain minimum annual thresholds, a company can earn 5 percent on qualified expenditures on qualified commercials. To be eligible for the 5 percent tax credit the production company must have more than $500,000 in total qualified costs attributable to the production of qualified commercials within the Metropolitan Commuter Transportation (MCT) or $200,000 outside the MCT. In the Growth program, a company can earn 20 percent on any incremental increase in qualified costs from one year to the next and it does not matter where in New York the qualified costs were incurred.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Estimated Revenue Impact of SB 370 For Taxable Years Beginning On or After January 1, 2015 Enactment Assumed After June 30,2014 ($ in Millions)		
2015-16	2016-17	2017-18
-$2.0	-$13.0	-$22.0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

LEGAL IMPACT

This bill would restrict the tax credit to commercial production conducted 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 in the state, employees employed in the state, etc., targeted tax credits such as those proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION[3]

Support: ACAFILMS; Association of Independent Commercial Producers Inc.; 1st Ave Machine; Aero Film; Arts & Science; Biscuit Filmworks; City of Big Bear Lake; Community Films; County of Kern Board of Trade; Crossroads Films; Duck; Durable Goods; Furlined; Gartner; GoFilm; Greendotfilms; Harvest; Hel-lo!; Heresy; Hungry Man; Imaginary Forces; Imperial County Film Commission; Imperial Woodpecker; Inland Empire Tourism Council/DiscoverIE; Inland Empire Film Commission; Kaboom!; KFilms; Lookout Entertainment; Marin Convention & Visitors Bureau; MILK; MJZ; Monterey Film Commission; Motiontheory; O Positive; Placer-Lake Tahoe Film Office; Prettybird; Rabbit; Radical Media; RESET; Ridgecrest Regional Film Commission; RSA Films; Sacramento Convention & Visitors Bureau; Sacramento Film Commission; Slim; Smuggler; Stardust Visions; Station Film, Inc.; Supply and Demand Integrated; The Directors Bureau; The Sweet Shop Film, LLC; Tool of North America; Traveling Picture Show Company; Tulare County Film Commission

Opposition: California Teachers Association

ARGUMENTS

Proponents: Some may argue that the commercial production credit would allow California to remain competitive and would help keep commercial production companies in the state.

Opponents: Some may argue that commercial production companies would remain in the state regardless of the tax credit.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a credit by the Legislature.

This bill would allow taxpayers in certain circumstances a credit in addition to otherwise allowable deductions. Generally, a credit is allowed in lieu of deductions in order to eliminate multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

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[3] As provided by in the Senate Governance & Finance's analysis of the bill as amended April 8, 2013.