Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Lieu	Analyst:	Jane Raboy	Bill Number:	SB 370
Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date: / Amended Date:	February 20, 2013 / April 8, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Qualified Commercial Production Credits

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 bill as introduced on February 20, 2013, would have expressed the intent of the Legislature to enact legislation that would stimulate job growth by providing incentives for the production of commercials.

The April 8, 2013, amendments removed the bill's provision on legislative intent and replaced it with the provisions discussed in this analysis. This is the department's first analysis of this bill.

REASON FOR THE BILL

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

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2014, and specifically operative for taxable years beginning on or after January 1, 2013.

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.

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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.

Refundable Credit

Tax credits that are not limited by the amount of an individual's tax liability are a "refundable credit" and results in money refunded back to the taxpayer. Currently, California has no refundable tax credits.

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]

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

THIS BILL

This bill would create two tax credits, Within the Studio Zone (Studio Zone Credit) and Outside the Studio Zone, for the production of a qualified commercial, as defined, by a qualified taxpayer, as defined.

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

1. Studio Zone Credit

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

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

- $13 million in credits for the 2012–13 fiscal year, and each fiscal year thereafter; plus any,
- Unused allocated credit amount from the prior fiscal year.

The aggregate amount of tax credits would be allocated on a pro-rata basis if the amount of credits applied for in any fiscal year by each qualified taxpayer exceeds the “Total Authorized Credit” for a qualified commercial within the studio zone.

If the amounts of credits allocated in a fiscal year are less than the “Total Authorized Credit,” for a qualified commercial within the studio zone, the remaining amount would be allocated to qualified taxpayers 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, including qualified wages, 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.

"Qualified commercial" would mean 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, cable, or interactive media, including, but not limited to, the internet, mobile devices,[3] in-game advertising, and experiential advertising where at least 75 percent of the total qualified expenditures occur wholly within the studio zone.

2. Outside the Studio Zone Credit

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

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

- $2 million in credits for the 2012–13 fiscal year, and each fiscal year thereafter; plus any,
- Unused allocated credit amount from the prior fiscal year.

The aggregate amount of tax credits would be allocated on a pro-rata basis if the amount of credits applied for in any fiscal year by each qualified taxpayer exceeds the "Total Authorized Credit" for a qualified commercial outside the studio zone.

If the amounts of credits allocated in a fiscal year are less than the "Total Authorized Credit" for a qualified commercial outside the studio zone, the remaining amount would be allocated to qualified taxpayers 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, including qualified wages, performed outside of the studio zone and within the state in the production of a qualified commercial.

[3] Mobile devices would include cell phones, smart phones, personal digital assistants, and other portable devices with a screen.

"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.

"Qualified commercial" would mean a commercial or advertisement composed of moving images and sounds that are recorded on film, videotape, or other digital medium, created for display on a network, regional channel, cable, or interactive media, including, but not limited to, the internet, mobile devices,[4] in-game advertising, and experiential advertising where at least 75 percent of the total qualified expenditures occur wholly outside of the studio zone and within the state.

Studio Zone Credit and Outside the Studio Zone Credit - Common Requirements and Definitions

This bill would use requirements that are defined under both tax credits as follows:

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 pass through to the partners or shareholders, and would not be allowed at the pass-through entity level.

Any state credit in excess of the state tax liability would be credited, by:

- Carrying forward the unused credit for a maximum of six years, if necessary, until the credit has been exhausted;
- Refunding 50 percent of the unused credit to the qualified taxpayer, and carrying forward 50 percent of the unused credit to the following taxable year; or
- Refunding the entire unused credit in the following taxable year.

The refunded portion of the commercial production zone credit would be provided through a continuous appropriation from the General Fund.

This bill would use defined terms under both tax credits as follows:

- "Employee fringe benefits" would mean the amount allowable as a deduction to the qualified taxpayer involved in the production of the qualified commercial; but limited by any amounts contributed by employees for the following:
  - o Pension, profit-sharing, annuity, or similar plan;
  - o Coverage under any accident or health plan; and
  - o Cost of life or disability insurance.

[4] Mobile devices would include cell phones, smart phones, personal digital assistants, and other portable devices with a screen.

- “Qualified commercial” would not include any of the following:

    - Program-length production with an advertising component in excess of five minutes,
    - Infomercial, news, or current affairs program, interview or talk program,
    - Network promotion (short-form content intended to promote other programming),
    - Feature film promotion (trailers and teasers),
    - Sporting event, game show, award ceremony, daytime drama, reality entertainment program,
    - Program intended primarily for industrial, corporate, or institutional end users,
    - Public service announcements, fundraising commercial or commercial promoting a political candidate or political issue,
    - Program consisting of more than one-half of the screen time of stock footage, and
    - Any program produced by an organization described in Section 527 of the Internal Revenue Code, or any production that falls within the recordkeeping requirements of Section 2257 of Title 18 of the United States Code.

- “Qualified individual” would mean an individual who performs services during the production period in an activity related to the production of a qualified commercial.

- “Qualified individual” would not be a related individual as described in Section 51(i)(1) of the Internal Revenue Code, or any 5 percent owner, key employee as defined in Section 416(i)(1)(B) of the Internal Revenue Code, of the qualified taxpayer.

- “Qualified wages” would mean all of the following:

    - Any wages required to be reported under Section 13050 of the Unemployment Insurance Code that were paid or incurred by a qualified taxpayer involved in the production of a qualified commercial with respect to a qualified individual for services performed on the qualified commercial produced within the studio zone.
    - Any payments made to a qualified taxpayer for services performed in the studio zone by a qualified individual.
    - Remuneration paid to an independent contractor who is a qualified individual for services performed within the studio zone by that qualified individual.
    - The portion of any employee fringe benefits paid or incurred by a qualified taxpayer involved in the production of the qualified commercial that are properly allocable to qualified wage amounts, as defined.

- “Qualified wages” would not include expenses, including wages, paid per person per qualified commercial for writers, directors, music directors, music composers, music supervisors, producers, and performers, other than background actors with no scripted lines.

- “Pass-thru entity” would mean any entity taxed as a partnership or “S” corporation.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations 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.

It is unclear when, how, and by whom the option to carryover the credit for the specified period or to have a percentage of the unused credit amount refunded would be selected. To avoid disputes between taxpayers and the department, the bill should be amended for clarity.

The FTB does not currently administer a refundable tax credit under the PITL or the CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems. Experience administering this program shows that the cost to detect fraudulent claims is significantly greater than anticipated.

The bill fails to specify the order that the refundable corporate credits would be applied. Lack of specificity could lead to disputes between taxpayers and the department and would complicate the administration of this credit. For example, a taxpayer with both non-refundable credits and a refundable credit that totals an amount greater than the tax liability would be due a refund if the refundable credit is applied after the non-refundable credits rather than before. The author may wish to amend this bill to apply the same ordering for refundable credits as currently specified under the PITL.

Because "qualified expenditures" must be paid or incurred within the credits' specified area, (i.e., within the Studio Zone for the Studio Zone Credit), the percentage of "qualified expenditures" would always be 100 percent and all commercials would meet the requirement that at least 75 percent of qualified expenditures be paid or incurred within the credit's specified area. If this is contrary to the author's intent, this bill should be amended.

This bill has inconsistent language on how the unused credit allocation would be applied. For example, this bill would provide that if the amount of credit applied for in any particular fiscal year exceeds the "Total Authorized Credit," the remaining amount would be required to be allocated to qualified taxpayers on a pro-rata basis. The inconsistency is found in another section that would provide that the remaining amount would be allocated to each qualified taxpayer on a pro-rata basis, not to exceed 15 percent of the qualified expenditures credit base. It would appear that the qualified taxpayer would have received an allocation equal to 15 percent of the qualified expenditure credit base already. If this is contrary to the author's intent, a revision is necessary.

TECHNICAL CONSIDERATIONS

The CTL Studio Zone Credit, line 33, page 16, needs to be amended where the phrase "Two million dollars ($2,000,000)" appears, as it should be "Thirteen million dollars ($13,000,000)" for consistency with the reference in the corresponding PITL Studio Zone Credit.

The CTL references in the PITL provisions have no legal effect and are unnecessary. On page 4 (lines 5-9) and on page 9 (lines 5-8), the sentence, "All members of a commonly controlled group, as defined by subdivision (b) of Section 25105, shall be treated as a single qualified taxpayer for the purposes of computing qualified expenditures." should be eliminated .

On page 15, line 18, the word "continously" should read "continuously."

Because the bill lacks a certification mechanism, the bill's references to certified credits would have no effect and should be deleted.

The term "cellphone" should be "cell phone."

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

The FTB does not currently administer a refundable tax credit under the PITL or the CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems.

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipate the costs to be significant.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 370 As Amended April 8, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
- $3.7	- $15.0	- $20.0

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[5]

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

[5] As provided by in the Senate Governance & Finance's analysis of the bill as amended April 8, 2013, available at: <http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0351-0400/sb_370_cfa_20130425_162037_sen_comm.html>

POLICY CONCERNS

Historically, the department has had significant problems with refundable credits and fraud. These problems are aggravated because if a refund is made that is later determined to be fraudulent; the refund commonly cannot be recovered. Striking the refundability provision from this credit would substantially reduce the department's concerns about fraud.

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

This bill would allow a credit for qualified wages and for the purchase or leasing of tangible personal property that are currently deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

Jane Raboy	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Acting Asst. Legislative Director, FTB
(916) 845-5718	(916) 845-5125	(916) 845-5683
jane.raboy@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov