

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Lieu Analyst: Jane Raboy Bill Number: SB 370  
 Related Bills: See Prior Analysis Telephone: 845-5718 Amended Date: July 3, 2013  
 Attorney: Patrick Kusiak 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 July 3, 2013, amendments would do the following:

- Require the California Film Commission (Commission) to post annually a listing of taxpayers allocated a tax credit on its Internet Web site, as specified;
- Require the Commission to maintain certain taxpayer information confidential or be subject to criminal penalties for the disclosure of the information, as specified;
- Modify the definition for "Qualified Expenditures" and "Qualified Commercial;"
- Allow the taxpayer to make an election to carry forward the excess credit or receive a refund, as specified; and
- Allow a tax credit in lieu of any other deduction allowed for expenditures.

The July 3, 2013, amendments resolved several, but not all, of the implementation, technical, and policy concerns by accepting the amendments suggested in the department's analysis of the bill as introduced on February 20, 2013, and amended on April 8, 2013, and raised additional implementation and technical considerations.

As a result of the July 3, 2013, amendments, the "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concerns" sections have been revised. The remainder of the department's prior analysis of the bill still applies. The "Fiscal Impact" section has been restated for convenience.

Board Position:

\_\_\_\_\_ S                      \_\_\_\_\_ NA                        X   NP  
 \_\_\_\_\_ SA                      \_\_\_\_\_ O                      \_\_\_\_\_ NAR  
 \_\_\_\_\_ N                      \_\_\_\_\_ OUA

Asst. Legislative Director

Date

Jahna Carlson

10/23/13

## **EFFECTIVE/OPERATIVE DATE**

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

## **ANALYSIS**

### 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 Commission would have the authority to allocate and certify an amount of credits for both the Studio Zone Credit and the Outside the Studio Zone Credit and would be required to maintain confidentiality of taxpayer information or be subject to criminal penalties on the disclosure of the information. 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.

This bill would require the Commission to annually post and make available for public release a list of qualified taxpayers and the tax credit amounts allocated to each qualified taxpayer, as specified, on its Internet Web site.

#### 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 could be allocated ("Total Authorized Credit") in any fiscal year would be equal to the following:

- \$13 million of credits in 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 to 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 could be allocated to qualified taxpayers outside of the studio zone 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.

“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,<sup>1</sup> in-game advertising, and experiential advertising where at least 75 percent of the total 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 to each qualified taxpayer if the amount of credits applied for in any fiscal year exceeds the “Total Authorized Credit” for a qualified commercial outside the studio zone.

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<sup>1</sup> Mobile devices would include cellular telephones, smart phones, personal digital assistants, and other portable devices with a screen.

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 could 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.

“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,<sup>2</sup> in-game advertising, and experiential advertising where at least 75 percent of the total expenditures occur wholly outside of the studio zone and within the state.

*Common Requirements and Definitions for the Studio Zone Credit and the Outside the Studio Zone Credit*

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.

50 percent of the credit amount in excess of the tax liability could be carried forward and applied to reduce the following year’s tax liability and a qualified taxpayer would make an election to do either of the following with the remaining 50 percent of the excess credit amount:

- Receive a refund.
- Carry forward the unused credit for a maximum of seven years, if necessary, until the credit has been exhausted.

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<sup>2</sup> Id.

The credits would be in lieu of any deduction otherwise allowable.

This bill would define the following terms for both tax credits:

- “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:
  - Pension, profit-sharing, annuity, or similar plan;
  - Coverage under any accident or health plan; and
  - Cost of life or disability insurance.
  
- “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 entity 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.

This bill fails to specify whether the Commission’s annual list would be based on a taxable year and whether the timeframe for the credit administration occurs before the credit may be claimed by the taxpayer. The bill also fails to require the taxpayer to obtain an allocation or certification from the Commission and lacks a cross reference to the subdivision that grants the authority of the Commission to determine how much of the credit any particular taxpayer is entitled to.

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.

This bill is silent on whether the Commission would issue a credit certificate to a qualified taxpayer upon the qualified commercial production credit completion, and after the qualified expenditures have been verified. It is also unclear if the qualified taxpayer would be allowed to claim a credit only when the name appears on the list or when a credit certificate is issued.

The FTB does not currently administer a refundable tax credit under the PITL and has never administered a refundable credit under the CTL. Establishing a refundable tax credit program would have a significant impact on the department’s forms and systems. Additionally, the department’s experience administering refundable PITL credits indicates that the cost to detect fraudulent refund claims would be significant.

The department would also need substantial time to develop adequate programs and operations to mitigate the potential for fraud and to ensure taxpayers receive the refund amount they are due. The operative date of this bill would make it difficult for the department to put in place necessary programs prior to the time taxpayers could file returns claiming the refund.

One half of the credit amount in excess of the tax liability for the taxable year would be limited to a one-year carryover period and, to the extent unused in that year, would expire while the remaining half could be refunded to the taxpayer or carried forward for up to seven years at the taxpayer's election. If this is contrary to the author's intent, this bill should be amended.

It is unclear how, when, and in what manner a taxpayer would make the election to carryover or obtain a refund of 50 percent of the credit amount in excess of the tax liability. Generally, elections are made on timely filed original returns and are irrevocable once made. The author may wish to amend this bill for clarity and to prevent disputes between taxpayers and the department.

This bill fails to specify the order that the refundable corporate credits would be applied.<sup>3</sup> 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. To avoid this, the author may wish to amend this bill to apply the same ordering for refundable credits as currently specified under the PITL.<sup>4</sup>

### TECHNICAL CONSIDERATIONS

On page 4, line 32, page 17, line 1, page 23, line 8, the phrase "qualified taxpayer" should read "qualified entity" to capture amounts paid to other entities for the services of qualified individuals who are not directly employed by the taxpayer.

On page 6, lines 19 and 21, page 12, lines 26 and 28, page 18 lines 29 and 31, and page 24 lines 36 and 38, the word "commission" should read, "California Film Commission".

On page 7, line 30, the word "both" should read "all" to provide for consistent use of terminology.

On page 8, lines 4-5, the phrase "and within the state" is redundant and should be deleted.

On page 9, line 37, and page 20 line 14, the phrase "outside the studio" should read "outside of the studio" to provide for consistent use of terminology.

On page 11, line 18, the word "may" should read "shall" to provide for consistent use of terminology.

On page 12, line 21, page 18 line 24, and page 24 line 31, the phrase "identified in or required to implement" should read "identified in, or required to, implement".

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<sup>3</sup> See Revenue and Taxation Code section 23036.

<sup>4</sup> See Revenue and Taxation Code section 17039.

On page 16, lines 30-33 and page 22, lines 37-40 should be deleted and should read "(ii) In the case of an "S" corporation, the credit allowed under this section shall not be used by an "S" corporation as a credit against a tax imposed under this part."

On page 19, line 3, the word "applications" should read "applicants".

On page 19, line 21, the punctuation mark "." should be replaced with a ":".

### FISCAL IMPACT

The FTB does not currently administer a refundable tax credit under the PITL and has never administered a refundable credit under 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 July 3, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment By September 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
-\$ 2.1	-\$ 4.9	-\$ 14.0

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

### **SUPPORT/OPPOSITION<sup>5</sup>**

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;

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<sup>5</sup> 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](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0351-0400/sb_370_cfa_20130425_162037_sen_comm.html)>

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

## **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 these credits 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 a credit by the Legislature.

Specific language is needed if the department determines that there has been an overpayment of any liability imposed under the PITL and the CTL, to provide that the overpayment may be credited against amounts due, if any, from the taxpayer and the balance, if any, should be refunded to the taxpayer. Absent this language, monies may be refunded even though a liability is due by the taxpayer.

This bill would allow taxpayers in certain circumstances to claim multiple tax credits for the same item of expense. Generally, a credit is in lieu of any other credit that may be claimed for the same expense.

## **LEGISLATIVE STAFF CONTACT**

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