F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/23/07
SPONSOR Robinson **LAST UPDATED** 3/05/07 **HB**

SHORT TITLE Media Arts and Entertainment Department Act **SB** 1186/aSJC

ANALYST Earnest

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY07	FY08		
	$500.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Senate Bill 1186 relates to House Bill 529, House Bill 757, Senate Bill 802, and Senate Bill 525.

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	($146.0)	($5,576.0)	Recurring	General Fund
		* See Narrative for Out-year Impacts		

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY07	FY08	FY09	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total			$500.0	$500.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)
State Investment Council (SIC)

SUMMARY

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment makes technical and other clarifying changes to the language of the bill.

Synopsis of Original Bill

Senate Bill 1186 creates a new sub-cabinet level department to consolidate state functions to develop a media arts and entertainment industry in New Mexico. An executive director would lead the department, which is composed of three divisions and six bureaus.

The bill sets the film production tax credit at 25 percent permanently, allows companies that claim the federal new markets tax credit to take the full 25 percent NM credit, and increases the credit to 30 percent for productions where 75 percent of their key "below the line" hires are NM residents, that are covered by collective bargaining agreement, and the key hires are members of the local union.[1]

The bill creates a new fund in the state treasury for the film museum.

The bill would transfer all functions, personnel, appropriations, money, obligations, and other property from the NM Film Division of the Economic Development Department and from NM Film Museum and its board of trustees from the Cultural Affairs Department to the new Media Arms and Entertainment Department.

Section 16 amends the State Investment Council (SIC) film loan program. Current statute allows the SIC to make investments, or 'buy', up to 2/3 ownership of a movie as an investment vehicle. The change in section C (6) lowers that amount to 1/3, thus requiring filmmakers to come up with 2/3 of their financing from other co-investors.

The bill appropriates $500 thousand to the DFA to establish the department.

FISCAL IMPLICATIONS

The fiscal impact is significant, especially in FY09 and beyond. The FY08 impact is limited to the addition of an extra 5 percent on the wages paid to "keys" if the film meets certain employment criteria. Using wage estimates from the NM Film office, the additional 5 percent credit results in a $230 thousand revenue impact in FY08. The bill will make the 25 percent credit permanent, resulting in a $5.6 million revenue impact in FY09 and an $11.4 million impact in FY10.

Total qualified expenditures approved for the film production tax credit were $75 million in tax year 2006. A total of $3.5 million in credit-related refunds were paid in FY 2006. So far in FY 2007, a total of $4.6 million in credit-related refunds have been paid. The estimates assume the following:

[1] "Below the line" payroll consists of those employees who do not have a participation interest in a project. Typically, lead actors, directors, writers and producers are excluded.

- Qualified expenditures will increase to $133 million in tax year 2007.
- Taxpayers will continue to delay their refund claims for a considerable period, with 33 percent claimed in the same year the credit is approved, 33 percent the following year and the remaining 33 percent in the second year following the approval.

Film Production Tax Credit: Senate Bill 1186				
	(thousands of dollars)			
	2007	**2008**	**2009**	**2010**
Assumptions:				
Total Qualified expenditures by tax year	133,000	146,300	160,930	177,023
Present law:				
Credit rate	25.0%	25.0%	20.0%	20.0%
Film Production credit approved by tax year	**(33,250)**	**(36,575)**	**(32,186)**	**(35,405)**
Credits claimed by year from approval	**33%**	**33%**	**33%**	**0%**
Film Production credit claimed by fiscal year	**(17,160)**	**(23,042)**	**(33,664)**	**(34,375)**
SB 1186:				
Credit rate	25.0%	25.0%	25.0%	25.0%
Increased credit for NM keys	(210)	(231)	(254)	(280)
Increased credit due to making 25% credit permanent			(8,047)	(8,851)
Film Production credit approved by tax year	**(33,460)**	**(36,806)**	**(48,533)**	**(53,386)**
Credit s claimed by year from approval	**33%**	**33%**	**33%**	**0%**
Film Production credit claimed by fiscal year	**(17,229)**	**(23,188)**	**(39,204)**	**(45,779)**
Impacts of SB 1186	**(69)**	**(146)**	**(5,576)**	**(11,444)**

Source: TRD and LFC analysis

The bill also makes an appropriation of $500 thousand, which is a recurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of fiscal year 2008 shall revert to the general fund.

<u>Continuing Appropriations language</u>

Section 20 of this bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

SIGNIFICANT ISSUES

The new department, headed by an executive director, would be organized into three divisions and six bureaus, as follows:

A. Administrative Services Division
B. Film Division
    a. Production Services Bureau

    b. NM Filmmakers Bureau
    c. Film Museum Bureau
C. General Media Arts and Entertainment Division
    a. Corporate services, games, animation bureau, digital imaging technologies bureau
    b. Music bureau; and
    c. Media Arts education Division

All divisions would be headed by directors exempt from the state personnel act.

The FY07 operating budget for the Film Division of EDD includes about $800 thousand and authorization of 12 FTE. Including the Film Office, the Film Museum, and the FTE and appropriations contained in this bill, the new department would have a budget of about $1.5 million and employ at least 19 people. Two boards – "Governor's Council on Film and Media Industries" and the Board of Trustees of the NM Film Museum – would advise the new department.

According to the Film Office, this act is in reaction to the rapid growth and expansion of New Mexico's film industry and the emergence of digital media (animation, visual effects, games, and applications of digital media into the medical and security fields) in the state. The Film Office also states that "the act addresses the need to secure and service digital media companies that are currently shopping for the ideal domestic headquarters for their operations and are leaning towards New Mexico. Expertise and resources are needed to maximize these opportunities." The Film Office, however, does not address why a new department is needed to cultivate this expertise and recruit these companies.

The growth of the film industry in the state is due largely to the 25 percent film production tax credit and the diligent services provided by the Film Office to production companies. In the first quarter of FY07, the state approved $5.7 million in tax refunds to production companies. At that rate, the state will likely return to companies more than $24 million from the general fund. Other subsidies the state provides to the industry include wage reimbursement for employees through the Job Training Incentive Program (JTIP) and zero-interest loans from the State Investment Council. The state has also invested more than $16 million in capital outlay appropriations for media production education programs at New Mexico's colleges and universities.

There is strong potential for significant growth of the digital media industry in the state. The Mesa del Sol development group and the state attracted Culver Studios to expand into New Mexico. Their new facilities – Albuquerque Studios – in conjunction with state incentives may help attract digital media companies and post-production facilities to the development.

SIC indicates that it has never made a direct equity investment in a film project, due almost entirely to the significant amount of risk involved in this asset class. The SIC, under guidance from its film advisor, has thus far invested or committed to invest in 20 films using an investment structure where the SIC grants loans of up to $15 million per project, accepting profit participation in lieu of interest. These loans are all guaranteed to return their principal to the SIC with an irrevocable letter of credit from an A-rated bank or equivalent corporate guarantee.

SIC:

The current investment loan structure is essentially a very-low risk investment in what many consider a high risk vehicle. If the SIC were to make direct equity investments in a film or

TV project, there is no buffer to reduce the SIC's risk, and this may well not qualify under Uniform Prudent Investor Act, which governs all investments made by the SIC.

The bill also makes the following change to section C (6), adding *"…The state investment officer shall consider economic development return to the state of local area in approving the investment."*

The SIC's position is that this language is overly vague in its intention and direction. Currently, as allowed under statute, Private Equity Investment Advisory Committee and State Investment Council members already consider the number of jobs, New Mexicans hired, projected budget, expenditures in NM, etc. when voting to approve a loan to a film/TV project, though those economic impact factors are secondary to the overall quality of the investment and its potential for return. This new language would require members to take this economic benefit into account, and possibly hold it at a higher level of importance than they do presently. The SIC also interprets this language to add extra weight to productions in rural locales, as referenced by *"the state of local area"*, in weighing their investment decision. Obviously a film production coming to a rural corner of New Mexico will have greater impact on a community in comparison to a production's arrival in Albuquerque, which has become more commonplace. The language, as stated, may simply be too subjective to influence a production's location choices or the subsequent Council's vote. The SIC is also unclear on how or by who, this impact would be defined for the Council.

PERFORMANCE IMPLICATIONS

The New Mexico Film Office has exceeded the performance measures every year for four years. The office tracks worker days, economic impact and number of productions, and has already exceeded its FY07 performance targets in the first six months of the year:

- Worker days are 97,803, well over the target of 75,000; and
- Economic impact* is stated at $200 million, exceeding the FY07 target of $140 million.

*Economic impact is calculated by multiplying company expenditures by three – an approximation that EDD believes to be an industry standard.

ADMINISTRATIVE IMPLICATIONS

EDD notes that the workload created by the large number of film productions coming into the state requires a disproportionate percentage of EDD's marketing, administrative services and legal staff resources. EDD's Public Information Officer is not currently handling the New Mexico Film Office's massive amount of press inquiries, press releases, or press opportunities. This function has been incorporated into NMFO's staff responsibilities (who do not have the expertise or time to handle this important element.) Creating this new agency would take the burden off of EDD to handle these administrative needs.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 1186 relates to Senate Bill 525 and House Bill 529, in the creation of a new department. SB 1186 relates to House Bill 757 and Senate Bill 802 in its tax provision.

TECHNICAL ISSUES

TRD raises several technical issues and suggestions, as included in related bills.

Allowing credit only once for each activity:
Present law is ambiguous about whether the tax credit can be claimed by more than one taxpayer for the same qualified activities. House Bill 757 as amended contains language intended to help clarify that the credit cannot be taken by two different taxpayers for the same qualified activity. Administration of this statute would be simplified if this bill would adopt the same language. The remaining problem is how should credits be allocated between two otherwise eligible taxpayers for expenditures related to the same services? For example, one film production company could provide services to another film production company in such a way that both companies would otherwise be eligible for the credit for their expenditures. As amended, the statute does not specify which company has the priority in claiming the credits. This could lead to disputes and litigation. One possible solution would be to stipulate in the statute that the company selling the services is the one entitled to the credit, for example:
"In the case of direct production expenditures in which one eligible film production company is purchasing services from another eligible film production company, where the selling company is eligible to claim a credit for expenditures undertaken to provide the services being sold, only the seller may claim the credit, and the buyer's eligible expenditures must be reduced by the amount of expenditures for which credit could be claimed by the seller."
This language could be added to Section 7-2F-1(A)(1) after the amendment already proposed, and also to 7-2F-1(A)(2) on postproduction expenditures.

Applicability provisions:
Income tax provisions usually need an applicability clause to clarify which activities qualify for the changed treatment proposed in the bill. Applicability language should be added to this bill, for example, "Provisions of the bill are applicable to tax years beginning on or after January 1, 2007.

Proof of residency:
New paragraph K of Section 1 of the bill would require proof of residency on the part of the keys employed by a production. The bill does not clarify how long a key would have to be a resident to qualify.

Anti-"Double-Dip":
Present law is silent about whether the Film Production Tax Credit can be claimed for expenditures that are also eligible for other tax incentives. Other incentives that might be claimed include Industrial Revenue Bond financing, the High-Wage Jobs Tax Credit, the Technology Jobs Tax Credit and others. The combined effects of multiple incentives may result in a subsidy that is much greater than that provided by any one section of statute. In order to limit the use of multiple subsidies for the same expenditures, the Film Production Tax Credit statute should be amended to state that "this credit is not available with respect to any expenditure for which the taxpayer claims any other tax credits.

ALTERNATIVES

Instead of creating a new department, the Legislature could give more authority and resources to the existing film office of the Economic Development Department, which is the principal business recruitment and retention arm of the state.

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