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FISCAL IMPACT REPORT

SPONSOR Kintigh **ORIGINAL DATE** 02/22/09
LAST UPDATED 02/24/09 **HB** 725

SHORT TITLE Repeal Film Production Tax Credit **SB** _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	\$54,000.0	\$63,000.0	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
Economic Development Department Film Office
State Investment Council (SIC)

SUMMARY

Synopsis of Bill

House Bill 725 repeals the film production tax credit effective July 1, 2009, and restricts the State Investment Council (SIC) to investing no more than 3 percent of the severance tax permanent fund in film entities. HB725 further requires that film investments made by the SIC are market rate investments and that the films are filmed wholly or substantially in NM, have distribution rights in place, and will hire mostly New Mexico residents.

FISCAL IMPLICATIONS

The latest revenue estimates assumed \$55 million for film tax credits in FY09 and \$60 million in FY10. Repealing the credit will increase corporate income tax revenues which go to the general fund. There would be some offset due to the decline in film activity that relied on the tax credit.

The impact of restricting the film loan program would essentially stop the film loan program and the future investments would be allocated elsewhere. Films that can pay market rates and have distribution contracts in place can usually obtain financing from commercial banks.

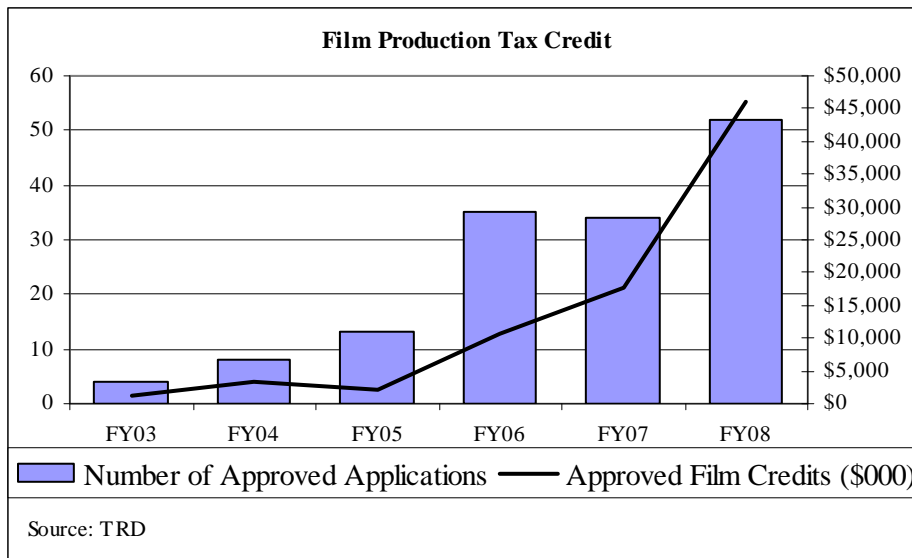
The Film Office warns of significant economic impact if the credit is repealed:

Repealing the film production tax credit would place thousands of New Mexicans on unemployment, beginning immediately. In addition, there are over 200 film-specific businesses and services in the state that would also go out of business.

SIC reports that there will not be significant fiscal impacts in the short term as the portfolio is reallocated to meet the 3 percent target in HB725 but that there is a concern that moving to “market rate” loans there is a higher risk of loan defaults. HB725 repeals the requirements regarding loan guarantors or letters of credit and SIC is concerned that this would expose the fund to more loan defaults.

SIGNIFICANT ISSUES

Film Credit Repeal. The film production tax credit is a 25 percent refundable credit on most taxable expenditures made in the state. The credit is against either personal income tax or corporate income tax liability and any excess above liability is returned to the taxpayer. Most of the credit to date has been applied against corporate income tax liability.



Governor Gary Johnson in 2002 signed into law House Bill 118 from the 2002 session which created the 15 percent refundable film production tax credit. The credit was scored to cost \$1.6 million annually according to the LFC fiscal impact report for HB118 in 2002. The credit was expanded in 2005 to include an additional 5 percent credit that was available through tax year 2008. At the time, TRD calculated the impact of the additional 5 percent credit at \$250 thousand. In 2006, the credit was expanded to 20 percent and the additional 5 percent through 2008 and another credit, the filmmaker’s tax credit, was repealed. TRD estimated that the cost would be \$1.8 million annually. At the time the Film Office reported an economic multiplier of 4. In 2007, the credit was expanded again to 25 percent and made permanent. At that time the fiscal impact for the film credit program was estimated to be \$33 million growing to \$50 million by FY12. In FY08, the film credit cost \$46 million.

The attachment has a profile of the motion picture and sound industry in New Mexico and projections from the Workforce Solutions Department.

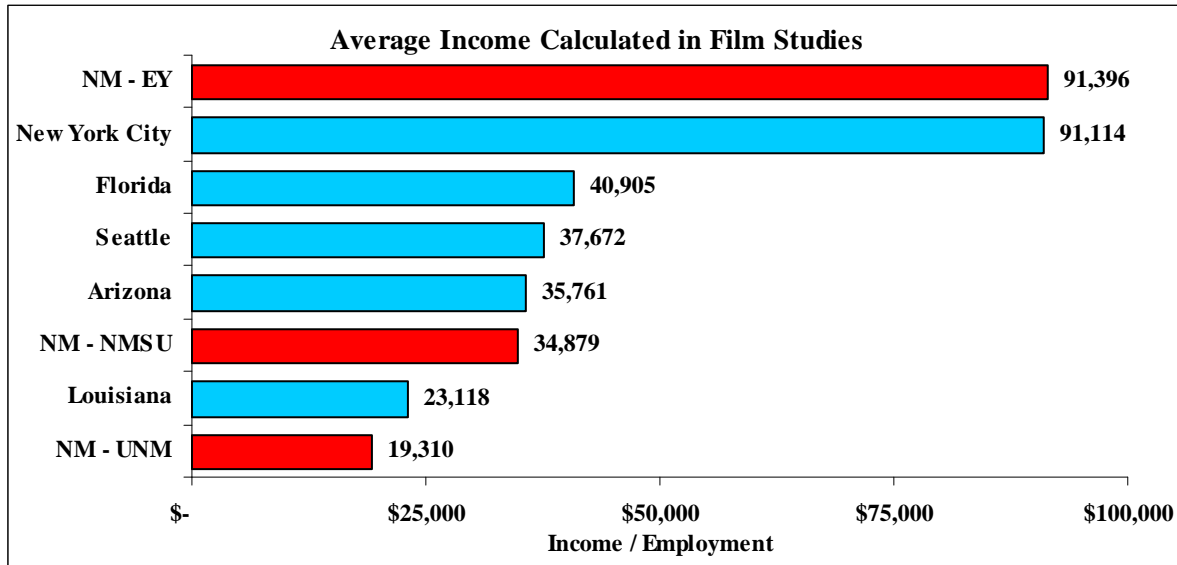
Film Studies. In 2008, after repeated requests for the Film Office to study the impact of the credit on state revenues, the LFC contracted with New Mexico State University Arrowhead Institute to analyze the impacts of the film credit and the return on the investment to the state. NMSU-Arrowhead looked at the film activity that was eligible for the credit and determined that the additional economic activity from film production generated 14.4 cents for every dollar of tax credit. The study was similar to other studies around the country in both methodology and results. NMSU has had significant experience in estimating economic impacts of various industries in New Mexico.

In the fall of 2008, the Film Office did conduct a study that included a survey of film industry participants and a survey done for the Department of Tourism on film tourism impacts. This study, conducted by Ernst & Young in Washington, DC, showed only a slight negative return on the state's investment and including local governments a net positive return. According to the study, for each dollar of credit, the state received 94 cents back from the tax generated from additional economic activity and 56 cents went to the local governments.

Film Office:

According to the recent study conducted by Ernst and Young's Quantitative Economics and Statistics bureau, over 9,000 New Mexicans are employed as a result of New Mexico's film and media industry. Large facilities such as the 100 million dollar Albuquerque Studios would shut down, with no viable reuse plan due to the specialized nature of the structures. Hotels, restaurants, car rental companies, lumber yards and scores of other non-film businesses would suffer severe losses in addition to the general slow down that has crippled their industries. Besides paying out on unemployment to thousands of New Mexicans, the state and municipalities would suffer a massive loss in PIT, corporate income tax, GRT, lodgers tax, excise tax, property tax. The E and Y study states that for each dollar in film production tax credits, the combined state and local tax revenue is \$1.50, thus in the 6 plus years of the film incentive, a total of \$50 million dollars in revenue between state and local taxes (just public section, not including economic impact to the private sector) has been gained in New Mexico. Therefore, without considering the possibility of growth, the state would lose at least 50 million dollars over the subsequent 6 years, not to mention massive foreclosures and bankruptcies. By changing the film loan program in the manner described, the program would have to be abandoned, and thus drive any remaining potential films to other states and countries. The investment that the state has made in our colleges and universities to train the next generation of New Mexicans in high-wage jobs would also be considered a loss.

Several other states and cities have studied the film industry's impact on the local economy. The E and Y study shows far higher impact than any other readily available study. The key differences between the E and Y study and other studies, including the other studies done by NMSU-Arrowhead and UNM-BBER are the assumptions regarding average wages and the inclusion of capital expenditure and tourism. It is hard to compare the latter two components of the E and Y study (tourism and capital expenditures) with other studies. The tourism component adds one-third of the return on investment making it a crucial piece of the conclusion that the credit nearly pays for itself. The comparable component are the assumptions about compensation. The chart below shows the assumptions about direct film production activity for various studies. The E and Y study has an average income equivalent to New York City which seems incongruous with other studies particularly ones done by the in-state research groups, BBER and Arrowhead..



Film Loan Program Restrictions. As of November 30, 2008, there was \$145 million in loan commitments and \$141 million in outstanding principal in 12 films or TV series. According to SIC’s monthly film report, SIC has an additional \$30 million that are in the process of closing and only has \$17 million capacity remaining. SIC can invest up to 6 percent of the severance tax permanent fund in film loans, considered part of its “economically targeted investment” (ETI) program. The ETI program has a double bottom line where considerations of economic development are compared with market return considerations.

SIC:

It should be noted that the one film loan to “default” its loan payments to the state (by the producers of *Bordertown*), actually came under a statutorily authorized program allowing similar market-rate film production tax credit loans. The loan was later repaid in full with penalty interest, but only under threat of litigation by the SIC. Following these difficulties, the SIC voted to end the policy and practice allowing such loans, in favor of only the guaranteed loan program. This “default” is widely cited as a failure of the overarching film incentives program by its critics, though the loan was ultimately fairly profitable for the state (\$300k earned at >9% penalty interest rate). To date the state has not lost a penny of principal on film loans, while sharing \$898,000 in profit with production companies.

It should be noted that the SIC’s film advisor, at the direction of its board members on the Council, has significantly toughened negotiation terms and conditions acceptable for project approval. The more stringent criteria has winnowed down the recent number of film investments overall. In Calendar Year 2008, the SIC negotiated profit sharing terms with only two projects seeking loans from the state. In all of 2007, only 4 projects received approval. Since inception in 2001, the SIC had approved and funded 24 projects total, in addition to initial approval (but no funding) for 7 other projects whose projects were either later cancelled or found more attractive funding terms from other avenues.

It should also be noted that while only a small minority of film productions which ultimately shoot in New Mexico actually access the film loan program, many others are lured here initially by the concept and the incentives package as a whole.

Other States. Most states now offer some version of the film credit though only Louisiana and Michigan are as expansive as New Mexico. Currently, New Mexico has an advantage because of the proximity to Los Angeles, which is still the hub of film activity, but the California legislature recently passed a credit that could slow the exodus from California. The Legislative Analyst Office, a nonpartisan legislative research office, has recommended against the credit saying “a 20 percent subsidy of the production expenses qualifying under this proposal would probably amount to over \$1 billion per year.” LAO continues that “it is not clear that the film industry’s situation is unique among industries that produce for a national or international market. If production costs for the film industry are higher here than in other locations, it is also likely to be true for the electronics, finance, chemicals, and food processing industries. The administration has not made the case that the film industry deserves special treatment because it faces unique challenges that other sectors of the economy do not experience.”¹

PERFORMANCE IMPLICATIONS

The film production credit is chiefly responsible for attracting film production to New Mexico and the repeal would make the film office fail to meet performance measures related to media industry worker days.

The restriction on the film loan program would very likely end or significantly curtail the program.

ADMINISTRATIVE ISSUES

SIC:

Due diligence would require additional staff or expertise to assess the creditworthiness of each applicant in an effort to limit the number of non-performing loans. This may require significant vetting of applicants, as well as foreign receivables expected through the required distribution deals HB 725 (and current law) hold in place. There is potential, depending on number of applicants for such loans, that without significant resources the administration of such a program may prove burdensome or even overwhelming to the agency.

TECHNICAL ISSUES

TRD notes it is not clear whether the effective date applies to film projects already in progress but which will not claim the credit until FY10 or whether it applies to film projects begun after July 1, 2009:

Is the July 1, 2009, effective date the date on which the credit stops completely and from which the Department no longer processes any credits or is it the date until which we will accept applications and then implement the new rules? It is not clear whether films currently being produced in the state would fall under the present law or if that determination would depend on the date of the application. The bill does not specify the treatment of a production company that has not submitted its claim or that is currently going through the approval process. Also, the credits that have been approved, but not refunded, may be affected.

¹ California Legislative Analyst Office “2009-10 Budget Analysis Series: Revenues” Feb 5, 2009.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House bill 404 amends the way film artists must withhold income tax and exempts film pass-through entities representing film performing artists from the gross receipts tax. HB404 also requires that expenditures are eligible if the vendor has a physical presence in New Mexico.

ALTERNATIVES

Options that rein in the expense to the state general fund like caps or expenditure restrictions could be considered. The Film Office has reported to the LFC that some expenditures such as hospitality could be disqualified which would target the credit to the specific types of expenditures that directly contribute to film production. HB404 establishes a physical presence requirement which should help target the credit.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The film credit will continue to cost the state tens of millions of dollars but film production in the state will maintain its high level of activity and potentially grow.

SIC will continue to invest in films that are guaranteed to repay the principal and that have an upside potential through profit participation.

NF/mt

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc

Here is a summary of the current labor market information on Subsector (3 digit) Motion Picture & Sound Recording Ind in New Mexico.

Description of Subsector (3 digit) Motion Picture & Sound Recording Ind 

Here is a description for the industry you have selected.

Subsector (3 digit) Motion Picture & Sound Recording Ind

Industries in the Motion Picture and Sound Recording Industries subsector group establishments involved in the production and distribution of motion pictures and sound recordings. While producers and distributors of motion pictures and sound recordings issue works for sale as traditional publishers do, the processes are sufficiently different to warrant placing establishments engaged in these activities in a separate subsector. Production is typically a complex process that involves several distinct types of establishments that are engaged in activities, such as contracting with performers, creating the film or sound content, and providing technical postproduction services. Film distribution is often to exhibitors, such as theaters and broadcasters, rather than through the wholesale and retail distribution chain. When the product is in a mass-produced form, NAICS treats production and distribution as the major economic activity as it does in the Publishing Industries subsector, rather than as a subsidiary activity to the manufacture of such products. This subsector does not include establishments primarily engaged in the wholesale distribution of video cassettes and sound recordings, such as compact discs and audio tapes; these establishments are included in the Wholesale Trade sector. Reproduction of video cassettes and sound recordings that is carried out separately from establishments engaged in production and distribution is treated in NAICS as a manufacturing activity.

Jobs Available for Sector (2 digit) Information 

Here are the current jobs available for Sector (2 digit) Information.

Industry Title	Jobs Available
Sector (2 digit) Information	79

Source: CORP [Corporate], PJB [Private Job Board], SJB [State Job Board]

Employers for Subsector (3 digit) Motion Picture & Sound Recording Ind 

Below is the number of employers for Subsector (3 digit) Motion Picture & Sound Recording Ind.

Industry Title	Number of Employers
Subsector (3 digit) Motion Picture & Sound Recording Ind	294

Source: infoUSA

Long Term Industry Projections for Subsector (3 digit) Motion Picture & Sound Recording Ind 

Below are the long term industry projections for Subsector (3 digit) Motion Picture & Sound Recording Ind in New Mexico.

Industry Title	2006 Estimated Employment	2016 Projected Employment	Total 2006-2016 Employment	Total Annual Avg Employment	Total 2006-2016 Percent	Total Annual Percent

			Change	Change	Change	Change
Subsector (3 digit) Motion Picture & Sound Recording Ind	2,847	4,141	1,294	129	45.5%	4.5%


Source: NMDWS, Economic Research and Analysis Bureau

Number of Firms and Workers for Subsector (3 digit) Motion Picture & Sound Recording Ind 

Here are the number of firms (establishments) and workers (employees) for the Subsector (3 digit) Motion Picture & Sound Recording Ind industry in New Mexico in 2nd Quarter, 2008.

Industry Title	Establishments	Employment
Subsector (3 digit) Motion Picture & Sound Recording Ind	205	3,126

Source: NMDWS, Economic Research and Analysis Bureau

Wage Summary for Subsector (3 digit) Motion Picture & Sound Recording Ind 

The average weekly wage for Subsector (3 digit) Motion Picture & Sound Recording Ind in New Mexico in 2nd Quarter, 2008 was \$741. This would be equivalent to \$18.53 per hour or \$38,532 per year, assuming a 40-hour week worked the year around.

Average Weekly Wage Statistics for Subsector (3 digit) Motion Picture & Sound Recording Ind 

Here is a list of average weekly wage information for Subsector (3 digit) Motion Picture & Sound Recording Ind. These figures are for the 2nd Quarter, 2008 time period.

Industry Title	Area	Average Weekly Wage
Subsector (3 digit) Motion Picture & Sound Recording Ind	New Mexico	\$741

Source: NMDWS, Economic Research and Analysis Bureau

Employees in Subsector (3 digit) Motion Picture & Sound Recording Ind by region 

Here are the number of employees for the Subsector (3 digit) Motion Picture & Sound Recording Ind industry by region in New Mexico as of the 2nd Quarter, 2008.

Region	Number of Employees
Bernalillo County	698
Chaves County	Confidential

Curry County	Confidential
Dona Ana County	Confidential
Eddy County	44
Grant County	Confidential
Lea County	Confidential
Lincoln County	Confidential
Los Alamos County	Confidential
McKinley County	Confidential
Otero County	Confidential
Quay County	Confidential
Rio Arriba County	Confidential
Roosevelt County	Confidential
Sandoval County	7
San Juan County	Confidential
San Miguel County	Confidential
Santa Fe County	1,075
Socorro County	Confidential
Taos County	30
Valencia County	Confidential
The State of New Mexico	3,126

Occupations in the Subsector (3 digit) Motion Picture & Sound Recording Ind industry



Here are the top 25 occupations for the Subsector (3 digit) Motion Picture & Sound Recording Ind in New Mexico. The number of employees is based on a 2006 estimate.

Occupation Title	Number of Employees
Counter Attendants, Cafeteria, Food Concession, an	317
First-Line Supervisors/Managers of Food Preparatio	87
Secretaries, Except Legal, Medical, and Executive	24
Actors	Confidential
Amusement and Recreation Attendants	Confidential
Art Directors	Confidential
Audio and Video Equipment Technicians	Confidential
Bookkeeping, Accounting, and Auditing Clerks	Confidential
Camera Operators, Television, Video, and Motion Pi	Confidential
Cashiers	Confidential
Computer Software Engineers, Applications	Confidential

Editors	Confidential
Executive Secretaries and Administrative Assistant	Confidential
Fine Artists, Including Painters, Sculptors, and I	Confidential
First-Line Supervisors/Managers of Construction Tr	Confidential
First-Line Supervisors/Managers of Retail Sales Wo	Confidential
General and Operations Managers	Confidential
Motion Picture Projectionists	Confidential
Multi-Media Artists and Animators	Confidential
Order Clerks	Confidential
Producers and Directors	Confidential
Production, Planning, and Expediting Clerks	Confidential
Sales Representatives, Wholesale and Manufacturing	Confidential
Set and Exhibit Designers	Confidential
Ushers, Lobby Attendants, and Ticket Takers	Confidential

Source: NMDWS, Economic Research and Analysis Bureau