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

SPONSOR Smith **ORIGINAL DATE** 03/03/10 **LAST UPDATED** **HB**

SHORT TITLE Film Production Tax Credit Cap **SB** 14

ANALYST White

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
$0.0*	$ 31,500.0	$ 38,700.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

*See Narrative

SOURCES OF INFORMATION

LFC Files

New England Public Policy Center at the Federal Reserve Bank of Boston

SUMMARY

Synopsis of Bill

Senate Bill 14 places a cap on the amount of film production tax credits which may be claimed in any one six-month period. The proposed cap would be set at $20 million semi-annually for a total of $40 million per tax year. If the amount of claims during any one six-month exceed $20 million then the Taxation and Revenue Department (TRD) is instructed to divide the $20 million cap proportionally across all applicable projects.

The proposed legislation carries an emergency clause.

FISCAL IMPLICATIONS

The proposed legislation would limit the amount of film production tax credits which may be awarded by the state to $20 million per six-month period. As such, the state could not award more than $40 million in tax credits in a single fiscal year. To date the state has awarded more than $45 million in FY10 film production tax credits and is expected to pay out $71.5 million and $78.7 million in FY11 and FY12 respectively by the consensus revenue estimating group. Therefore it can reasonably be inferred that enactment of this legislation would result in additional tax revenue of $31.5 million in FY11 and $38.7 million in FY12. It is unclear what the effect of the proposed legislation would be on FY10 as the state is already estimated to have paid out more than $20 million for the current six-month period. This issue is discussed in greater detail in the technical issues and alternatives sections below.

Dynamic Analysis. While the proposed legislation would result in increased corporate income tax receipts, these increases would be partially offset by a probable decline in film activity that existed due to the credit not being capped. The exact amount of offset at this time is indeterminable due to the absence of "dynamic analysis" in this FIR. The two studies that have been conducted on the potential economic impacts of the film industry in New Mexico are examples of dynamic analysis and are discussed in great detail in the significant issues section below. This type of analysis attempts to capture the full economic consequences of state tax policies, taking into consideration all of the potential actions and reactions of economic actors in the state. The wide disparity in results of the two studies illustrates how complex this analysis can be and also the difficulty of coming to a consensus on the correct assumptions and methods to use. Notwithstanding all of the work done on these studies, they did not address a number of the important factors affecting economic impacts. These include the question of how the state's spending policies are affected by the proposed use of tax revenue, and whether the new workers employed in the film industry are from New Mexico or from another state. Because of the difficulty of deriving results that are reliable and also the difficulty of reaching a consensus on this type of analysis, the LFC has decided not to include dynamic analysis in FIR's. Although it could be argued that this means the LFC FIR's are biased, the alternative would be to introduce uncertainty and questionable results into the FIR's that would make them less reliable and more inconsistent. As an example of the wide discrepancies which sometimes accompany dynamic analysis, the tables below show the estimated impacts of the film production tax credit program under current law using assumptions made by both film studies performed for the state of New Mexico.

In its analysis of related legislation, House Bill 52 during the 2010 regular session, the New Mexico Film Office indicated that it anticipates film industry direct spending of $150 million in FY11 yielding tax credits of $37.5 million. This number is just over half the $71.5 million estimated by the consensus revenue group, made up of economists from DFA, TRD, DOT, and LFC. This assumption has already been proven false as the state has awarded more than $45 million in film production tax credits in FY10 to date. However, this scenario is still included to demonstrate the sometimes wide discrepancies present in dynamic analysis. Using the results of two studies on the benefits of New Mexico's film production tax credit program, the following general fund impacts can be estimated under current law.

GF Impacts of Film Production Tax Credit Using Film Office Activity Estimates:

	Ernst & Young	Arrowhead Center
Direct Film Spending	$ 150.0	$ 150.0
Tax Credit	$ 37.5	$ 37.5
Revenue per $ of Credit	0.94	0.14
Revenue from Film Spending	$ 35.3	$ 5.25
Gain/(Loss) to the State	$ (2.3)	$ (32.25)

* Dollars in Millions

GF Impacts of Film Production Tax Credit Using Consensus Revenue Activity Estimates:

	Ernst & Young	Arrowhead Center
Direct Film Spending	$ 286.0	$ 286.0
Tax Credit	$ 71.5	$ 71.5
Revenue per $ of Credit	0.94	0.14
Revenue from Film Spending	$ 67.2	$ 10.01
Gain/(Loss) to the State	$ (4.3)	$ (61.49)

* Dollars in Millions

SIGNIFICANT ISSUES

Film-Production Tax Credit. 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 FY09 the state paid out nearly $76.7 million in film production tax credits

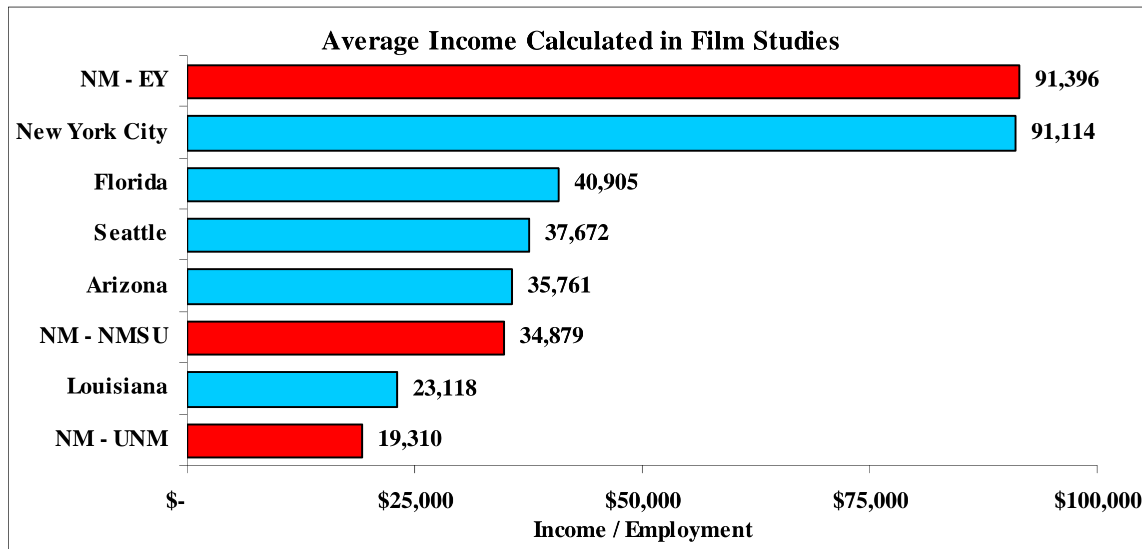
Film Studies. In 2008, after repeated requests for the Film Office to study the impact of the credit on state revenues, the LFC contracted with the Arrowhead Center at New Mexico State University to analyze the impacts of the film credit and the return on the investment to the state. NMSU-Arrowhead looked 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 estimating economic impacts of various industries in New Mexico.

In the fall of 2008, the New Mexico Film Office in conjunction with the SIC conducted a study of the film production tax credit program that included a survey of film industry participants and a survey by 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.

Due to the significant differences between the Ernst and Young film study and a number of other studies performed throughout the country including the analysis done by the Arrowhead Center, the New England Public Policy Center (NEPPC) at the Federal Reserve Bank of Boston published an analysis of the various studies in April of 2009. The analysis questions various

aspects of Ernst and Young studies performed in New Mexico and New York, including model calibration, lack of a balanced budget assumption, the amount of economic activity actually attributable to the film-credit, questionable wage and salary assumptions, and lack of detail surrounding the compilation of tourism impacts. The analysis states that "although some of the methodological choices made by the E&Y authors are legitimate, there are several problems with the studies that lead us to question the accuracy of their findings." The summary also states that "… some of the decisions of the E&Y authors—such as the failure to include a balanced budget requirement—cannot be easily justified."

Several other states and cities have studied the film industry's impact on the local economy. The Ernst and Young study shows a much greater impact than any other readily available study. The key differences between the Ernst and Young 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 expenditures and tourism. It is hard to compare the latter two components of the Ernst and Young 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 components are the assumptions about compensation. The chart below shows the assumptions about direct film production activity for various studies. The Ernst and Young 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.



Based upon both studies results and methodologies, LFC staff compiled their own analysis of the two studies in 2009. The results of the analysis showed that a number of differences in assumptions and time periods were to blame for the rather wide discrepancies between the two studies. However the LFC analysis came to the primary conclusion that while the Ernst and Young study undoubtedly overstates the financial return to the state, the Arrowhead Center study most likely understates the financial benefit to the state. The 2009 LFC analysis came to the conclusion that on a purely apples to apples comparison of the two studies the actual return to the state from the film production tax credit was roughly 25 cents for every dollar.

The most important conclusion that can be made as a result of all of the various analyses performed by the NEPPC at the Boston Fed, Ernst and Young, the Arrowhead Center, and LFC staff, is that the overall financial return to the state is negative. Even using the most positive of all the studies performed the state is still losing 6 cents for every dollar it pays out in film credits. Therefore in order to validate the continued use of the film production tax credit as an economic development tool, significant positive externalities, or non-financial benefits, must be proven to accompany the film industry in New Mexico. This represents a conscious policy decision that must be made regarding whether or not the positive externalities provided to the state by the film industry outweigh the financial loss.

TECHNICAL ISSUES

The mechanics of the proposed legislation pose potential problems related to awarding pieces of the $20 million cap to all applicable film projects proportionally. The primary issue relates to the fact that film companies will ultimately not know how much film credits they will be receiving until the distribution from TRD is made. This creates uncertainty in the film financing process and could deter productions from locating in New Mexico. Also it is unclear what effect the proposed legislation would have on FY10 as it is estimated that the state has already paid out more than $20 million for the current six month period. There are a number of alternatives which may prove more effective in limiting the negative revenue impacts on the state related to the film production tax credit program.

ALTERNATIVES

Instead of allowing TRD to proportionally award film credits based upon the amount of demand in any six-month period, it may prove more efficient to fully award productions their respective share of credits on a first come first serve basis. Once the cap is reached for that particular time-period, those productions which did not receive their credits will be first in line to receive them under the next period's cap. While this will most likely result in the delayed receipt by some productions of their credits, it does allow each production to receive its total share of credits and simultaneously ensures that the state will not pay more than a certain amount of credits in any one particular fiscal year.

Various other states have recently enacted various changes to their film production tax credit statutes in order to maximize benefits to their respective economies including:

- <u>Prioritizing productions in poverty areas.</u> Illinois provides an additional 15 percent credit for labor expenditures by the employment of residents in geographic areas with high unemployment and poverty. Texas provides an additional 2.5 percent for filming in underused or economically distressed areas. New Mexico could roll back the credit to 20 percent but provide a 5 percent incentive for productions in poverty areas, census tracts with high poverty, etc.

- <u>Providing an incentive to a production that provides a "brand" or "image" to New Mexico.</u> To someone outside the state, it may be difficult to know which movies were filmed in New Mexico. The tie to tourism would be improved. People visit Hollywood, because that has become a "brand" or 'image'. Georgia provides an additional 10% tax credit when productions place the Georgia logo (Georgia Peach) on movie trailers, posters, and credits of the film.

- Requiring a minimum percentage of the production occur in the state. Massachusetts and Maryland require that at east 50 percent of the production's filming must occur in the state in order to be eligible for the credit, Pennsylvania requires 60 percent, while Puerto Rico requires 50 percent of the principal photography OR if less than 50 percent, the production must spend at least one million dollars ($1M) in payment to Puerto Rico residents, Wisconsin requires 35 percent.

- Requiring productions to be "headquartered" in the state. Tennessee provides a rebate of 17 percent, however, if the production is headquartered in the state then an additional 15 percent is allowed, bringing the total credit to 32 percent.

- Prioritizing digital media, pre- and post production, and sound production. Build the industry vertically instead of just horizontally. Provide an additional incentive for local musicians, symphonies, etc.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Leaving the program in place without a cap will result in the General Fund paying out an estimated $70.2 million in additional tax credits over the next 2 fiscal years.

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