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

		ORIGINAL DATE	2/5/16		
SPONSOR	Torraco	**LAST UPDATED**	2/8/16	**HB**	
SHORT TITLE	Film Production Tax Credit for Distribution			**SB**	238
				ANALYST	Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**	**FY20**		
	No Revenue Impact					

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		Up to $32.0	Minimal	Up to $32.0	Nonrecurring	General Fund

Parenthesis ( ) indicate expenditure decreases

Relates to SB 211

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 238 amends the Film Production Tax Credit Act to create an additional credit for film production companies that provide distribution services in the state. The credit is equal to 25 percent of distribution costs for a film or commercial audiovisual product of the company, provided that the credit shall not exceed the combined amount of credit the company is allowed in the same taxable year for direct production and postproduction expenditures for qualifying films shot in New Mexico. The number of out-of-state films for which a company receives credit shall not exceed the number of qualified films shot in New Mexico in the taxable year.

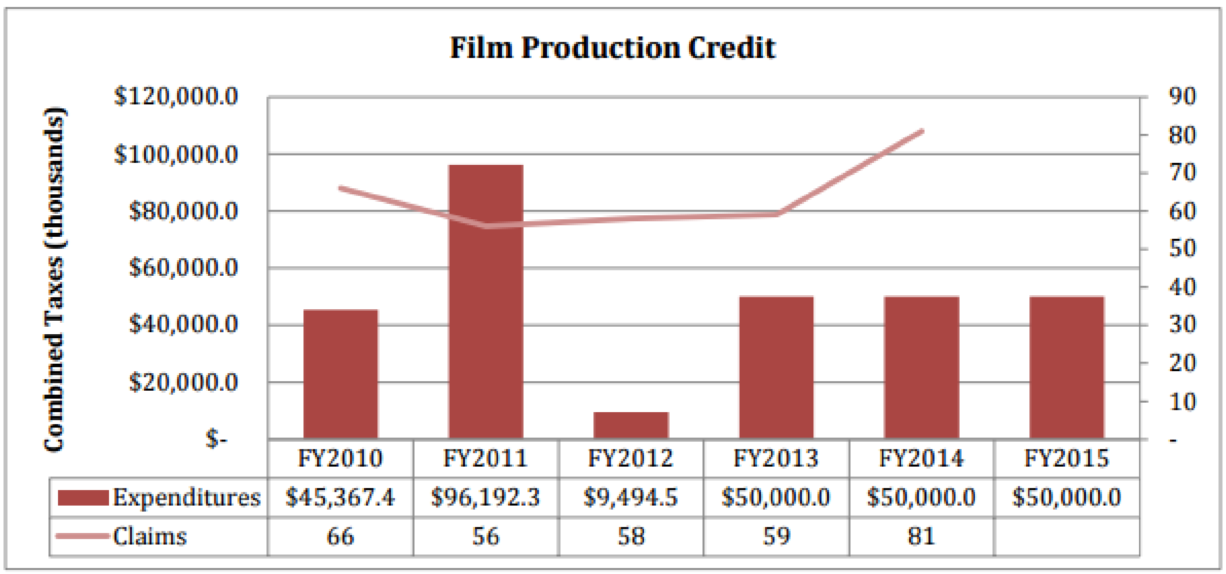
The bill also corrects a statutory reference.

The additional credit provisions apply to film production companies that commence principal photography on or after July 1, 2016.

FISCAL IMPLICATIONS

This bill has no revenue impact because the of the existing $50 million annual cap for combined credits under the Film Production Tax Credit Act, but the bill might create small operating budget impacts for the Taxation and Revenue Department (TRD) and the Film Office of the Economic Development Department (EDD) to administer this additional credit and update reporting forms.

TRD estimates it would take about 400 man-hours to update the systems, reports, and procedures to accommodate the new credit. Additionally, there would be a minimal impact to the revenue processing procedures and a minimal impact to the financial distribution business processes. The agency estimates this total one-time operating budget impact would be $32 thousand.



2015 New Mexico Tax Expenditure Report

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Estimating the cost and benefits of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

This bill could encourage film and audiovisual product distribution services in the state.

TRD reports the following intended purposes and goals for the film production tax credit are to:

1. establish the film industry as a permanent component of the economic base of New Mexico;
2. develop a pool of trained professionals and businesses in New Mexico to supply and support the film industry in the state;
3. increase employment of New Mexico residents;
4. improve the economic success of existing businesses in New Mexico; and
5. develop the infrastructure in the state necessary for a thriving film industry.

The additional credit proposed by this bill appears to align with the above purposes and goals. However, with total annual credit receipts limited to $50 million, and with recent and projected claims reaching that amount, any credits received through this additional credit would serve to delay other credits farther back in the queue. This could result in delayed payments for production and postproduction of films in the state. While carryover credits receive first priority in following years, there is potential for a shift in film-related activity to occur. Additionally, any delay in receipt of credits has the potential to impact small, independent filmmakers to a greater extent than major production companies due to different financing mechanisms available to each.

EDD provided the following analysis.

> The bill allows a 25 percent tax credit of "distribution costs" for "distribution services" in an amount not to exceed the combined amount of credit for direct production expenditures and postproduction expenditures. Additionally, they would receive the credit for projects not produced in the state, as long as the number of projects did not exceed those produced in New Mexico in the same taxable year.
>
> - We take this to mean that if a production company produced three projects in New Mexico with a total qualifying spend of $200 million, they would be allowed an additional $200 million of distribution costs for those projects plus three projects produced in another state or country. Of the $100 million credit the company receives, a portion of $50 million can go to projects from out-of-state or overseas that have put no investment in the state.
> - There are no limitations on "salary and wages," so a person making $1 million/year may be eligible.
> - Because cable channels, networks, and even websites who produce their own content can be viewed as distributors, there may/will be serious unintended consequences regarding eligibility.
> - The term "commercial audiovisual product" includes postproduction, games, apps, and webisodes, making these projects eligible. Again, there may/will be serious unintended consequences regarding eligibility.
> - Cap space may ultimately go only to companies that can distribute their own product, leaving many, if not most local New Mexicans unable to access the film tax credit.

ADMINISTRATIVE IMPLICATIONS

TRD already has a procedure in place for the application and claiming of other tax credits under the Film Production Tax Credit Act. However, the amendment would require additional forms, instructions, and procedures to accommodate the new credit.

TRD also notes that in an already complicated regime, the proposed bill sets additional comparative caps within caps, allowing distribution expenditures only in relation to production expenditures. TRD assumes that the Film Office would monitor these caps. Therefore, input would be needed from the Film Office to determine the degree to which these limitations affect the administrative burden, if at all.

RELATIONSHIP

This bill relates to SB 211 with respect to conforming references.

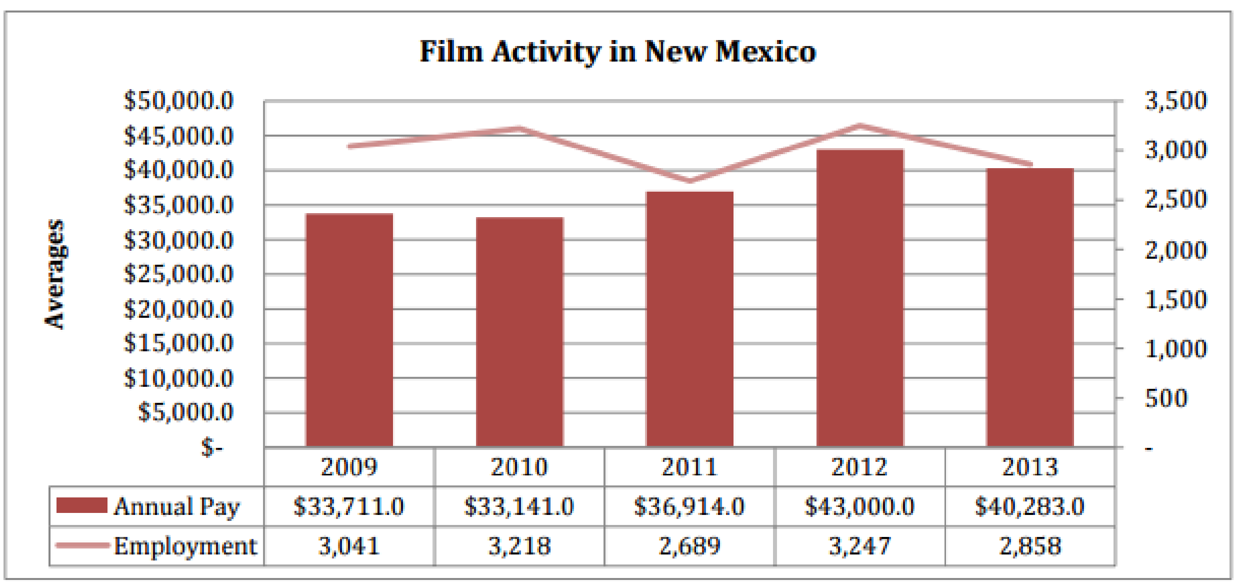
TECHNICAL ISSUES

TRD notes a technical issue in Section 2(B)(3) (page 6, line 13) and recommends consideration should be given to the breadth of the definition of "distribution services." As drafted, the bill's use of "services… directly attributable to the process of making a film or commercial audiovisual product available for commercial exhibition" is very broad, especially in comparison to the narrowly described production expenditure definitions and requirements. The variance in language could be interpreted as intent to be more inclusive in allowing tax credits claimed for film distribution activities than those allowed for production activities.

The bill provides that the number of out-of-state films for which a company receives credit shall not exceed the number of qualified films shot in New Mexico in the taxable year; however, this does not specifically reference the number of qualified films for which the company is applying for credit in the taxable year. This could be interpreted to say a company may receive credit for a number of out-of-state films up to and including the number of all qualified films shot in New Mexico by all companies within the taxable year. This may or may not be the intention.

OTHER SUBSTANTIVE ISSUES

Below is a chart showing historical film employment and average annual pay in New Mexico.



2015 New Mexico Tax Expenditure Report

TRD reports the following additional discussion related to the bill.

Films cannot be financed without the help of independent distributors as they often have influential business relationships with theater owners and operators. Film distribution refers to the marketing and circulation of movies in theaters and for home viewing. Its main goal is the delivery of the film to its largest possible audience. Distribution companies usually own the distribution rights of the films they help create and they have access to large capital assets. Films are usually expensive to make and distribution companies and the decisions of their conglomerates' are often profit-driven. Distribution costs data is difficult to obtain through public channels as they are often published under "other costs". They are often aggregated to promotion costs which could make them larger than production costs relative to total costs. Distribution companies' main source of revenue stems from ticket sales. The revenue share percentage from ticket sales is not pre-determined as it varies depending on several factors such as the estimated success of the film at the box office and the depth of the business relationship the distributor has with theater operators and owners. Other main sources of revenue for film distributors are DVD sales, TV rights, and merchandising.

Step-By-Step Film Distribution Process

1. Producer/Distribution company acquires rights to film story or treatment
2. Screenplay is developed by one or more writers
3. Production finance and cast & crew are confirmed
4. Principal photography takes place in studios and/or agreed locations followed by some time for post-production, editing and scoring
5. Distributor develops release strategy considering the release date and takes delivery of master print of the finished film
6. Distributor presents the film to exhibitors and negotiates bilateral agreements to have the film shown in theaters
7. Distributors' marketing campaign aims to create expectation amongst a large audience to launch the film to
8. Film prints/ disks are developed after the film's rating has been certified and are delivered to theaters before opening day
9. The length of time a film is exhibited at the theaters may be extended if the distributor engages in additional marketing efforts
10. Following its run on theaters, the film is released through other channels like DVD, pay-per-view, and streaming.

Stephen Follows' survey key findings about film distribution costs are:

- Average sales agent commission is 19 percent
- Average international distributor commission is 27 percent
- Average U.S. distributor commission is 30 percent
- Average movie theatre commission is 44 percent
- There is a clear trend of each sector reporting that their fees were lower than the rest of the industry thinks. For example, those in Exhibition report that cinemas take a 43 percent commission, whereas those in Sales & Distribution put the cinema share at 49 percent. This is quite telling as they are selling to each other so one would expect their guesses would align.
- As well as providing low estimates of their own fees, both sectors reported high estimates for the other. For example, Exhibitors feel the average fee charged by a U.S. distributor is 36 percent, whereas those working in Sales & Distribution put that figure at 28 percent.

Large distribution companies currently operating in the U.S. are:

- Viacom,
- Paramount,
- United International Pictures (UIP),
- Time Warner,
- New Line Cinema,
- Fox Entertainment Group,
- The Walt Disney Company,
- Miramax,
- Buena Vista International,
- Universal Studios Group, and
- Sony Corp.

JC/al