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FISCAL IMPACT REPORT

		ORIGINAL DATE	01/30/17		
SPONSOR	Ely/McCamley	**LAST UPDATED**	02/09/17	**HB**	192/aHBIC
SHORT TITLE	Film Tax Credits & Residency			**SB**	
				ANALYST	Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
$0	($3,768.0)	($4,897.1)	($6,050.0)	($7,507.3)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$30.3	$0	$0	$30.3	Nonrecurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment corrects the technical issue with the original bill that prevented the cap from growing annually as intended. Using forecasts for CPI-U growth rates, the cap (and the general fund impact) grows each year.

Synopsis of Original Bill

House Bill 192 performs two primary functions. First, it removes the static $50 million annual cap on payouts from the film credit and replaces it with a cap starting at $53.8 million for FY18 and increases the cap each year thereafter by a consumer price index for urban consumers (CPI-U) function. The function places the CPI-U for the previous calendar year as the numerator and the CPI-U for the most recent calendar year as the denominator. However, as these calculations are to be performed by the Taxation and Revenue Department (TRD) on April 30 of each year, the numerator and denominator would be the same, resulting in the cap remaining at $53.8 million.

Second, the bill requires TRD to promulgate rules to govern the process of determining residency for the purposes of the credit.

The effective date of this bill is July 1, 2017.

FISCAL IMPLICATIONS

Assuming the bill language is corrected to adjust the cap upward by the rate of inflation as measured by CPI-U, in its response, TRD notes the lack of escalation constraints on the index is a significant risk. Significant price fluctuations expose the state to future investments that may exceed collected revenues.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost 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

Even at this late date, there is still controversy whether the film production tax credit returns more to the state and local governments in additional tax revenue than the static cost of the credit paid by the general fund. The January 2017 *LFC Volume III* contains a cost per job created chart that estimates the cost of the film credit at nearly $29 thousand per job (direct cost*), annually. In order to create and retain an average job in the film industry, the state must pay that amount through the credit every year or risk potentially losing the job. Looking long-term at the total cost for a film industry job, it would be a multiple of the $29 thousand. For example, the Job Training Incentive Program (JTIP) is estimated in the same document to have a one-time cost of $6,000. If that job lasts four years, the cost for that program to create the job is still $6,000. However, to keep a film job for four years, the cost is $115.6 thousand.

> * Note the *LFC Volume III* cost per job chart lists only direct costs without considering indirect and induced effects as the vast majority of the job creation programs and tax expenditures on the list do not have associated studies estimating indirect and induced effects. Additionally, different assumptions and methodologies can result in substantially different cost estimates, so considering direct costs only – while imperfect – is currently the best way to achieve an apples-to-apples comparison.

TRD provided the following information regarding the residency requirements of the bill.

> Section 7-2F NMSA 1978 defines "New Mexico resident." Additionally, by statute, to be eligible as a qualifying production cost, the New Mexico resident filed income tax returns as a New Mexico resident in the two previous taxable years. TRD, in conjunction with industry, promulgated processes – in addition to current regulations – to ensure better compliance with the resident requirement. Industry may use non-resident resources, but at a reduced percentage, subject to specific statutory requirements. Thus, TRD and industry are proactive to the requirements of Section 2 of the proposed legislation.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the annual reporting provided and detailed studies evaluating the effectiveness and other attributes of the credit.

ADMINISTRATIVE IMPLICATIONS

There is a minimal administrative impact. Updates to systems and forms will be necessary. Most costs can be absorbed in conjunction with annual updates for each tax year.

TECHNICAL ISSUES

The intent appears to be to increase the credit's cap by the annual inflation rate as measured by CPI, but the phrasing needs to be adjusted to have that effect. TRD provided the following detailed description of technical issues.

> CPI-U is calculated and published by the Bureau of Labor Statistics. TRD recommends using the data provided by the responsible federal agency.
>
> The use of CPI-U creates uncertainty for industry and the state. During periods of declining prices, the CPI-U ratio will be less than 1.0, and therefore, the state's investment will be less than the prior year's investment. Similarly, during periods of rising prices, the investment will be higher than 1.0. This creates a significant risk to revenues for the state; during a period when prices spike, the investment could be significantly higher than the previous year's. Therefore, if CPI-U – or any annual multiplier – is to be used to calculate the state's investment, the legislation should prescribe a floor and a ceiling.
>
> However, as written, the numerator is the previous year and the denominator is the current year, which inverts the relationship. During a period of rising prices, the denominator (current year) is greater than the numerator (prior year); thus the ratio will be less than 1.0. The mandate that the current year "…shall not be less than…the fiscal year prior…" is contrary to the proposed statutory calculation. Furthermore, during periods of declining prices, the ratio will be greater than 1.0, increasing the investment during a period of declining revenues.

> Accelerating payments when in-year credit claims are less than the aggregate cap guarantees industry that the state will always invest the statutory cap. Eliminating this requirement – or allowing TRD use discretion during periods of weak revenue collection – will improve state revenue flows.

This credit does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?
1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters. 2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. 3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies. 4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date. 5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure. 6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✘	
Targeted		
Clearly stated purpose	?	Not explicitly stated
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✓	Multiple studies have been performed
Expiration date	✘	
Effective		
Fulfills stated purpose	✓	The incentive is effective in attracting film productions to the state and generating local employment in the industry
Passes “but for” test	✓	This incentive is one of only a few that clearly passes the “but for” test – the film productions and jobs would largely not exist but for the existence of the incentive
Efficient	?	The efficiency of the credit is debatable
Key: ✓ Met ✘ Not Met ? Unclear		

JC/jle/sb/al