

## ASSEMBLY THIRD READING

AB 1069 (Fuentes)

As Amended May 18, 2011

Majority vote. Tax levy

ARTS, ENTERTAINMENT, SPORTS 9-0REVENUE & TAXATION 8-0

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Ayes: Campos, Olsen, Achadjian, Butler,  
Carter, Gatto, Mendoza, Monning,  
SilvaAyes: Perea, Donnelly, Beall, Charles Calderon,  
Fuentes, Gordon, Harkey, NestandeAPPROPRIATIONS 16-1

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Ayes: Fuentes, Harkey, Blumenfield,  
Bradford, Charles Calderon, Campos,  
Davis, Donnelly, Gatto, Hall, Hill,  
Lara, Mitchell, Nielsen, Solorio,  
Wagner

Nays: Norby

SUMMARY: Extends the operation of the California Motion Picture Tax Credit for five additional years, from July 1, 2014, until July 1, 2019. Specifically, this bill:

- 1) Authorizes the California Film Commission (CFC) to allocate annually the motion picture tax credits, under both the Personal Income Tax (PIT) and the Corporation Tax (CT) Laws, to qualified applicants for five additional fiscal years (FYs), from July 1, 2014, until July 1, 2019.
- 2) Specifies that the aggregate amount of motion picture tax credits that may be allocated by the CFC in any FY is limited to \$100 million, through and including FY 2018-19.
- 3) Ensures that the film tax credit assigned to, or sold to, an unrelated taxpayer may be claimed by that taxpayer as a "qualified taxpayer."
- 4) Clarifies that the otherwise applicable limitation on the utilization of credits by a disregarded entity does not apply and that the disregarded entity may sell the film tax credit to an unrelated taxpayer.
- 5) Deletes duplicative sections of the Revenue and Taxation Code (R&TC).
- 6) Takes effect immediately as a tax levy.

FISCAL EFFECT: The Franchise Tax Board staff estimates this bill will result in an annual revenue loss of \$11 million in FY 2013-13, \$49 million in FY 2014-2015, and \$83 million in FY 2015-16, with the estimated total revenue loss of \$357 million for the following FYs.

COMMENTS:

Author's statement. The author states that, "California suffered both job and financial losses as hundreds of productions have left the state to seek incentives offered elsewhere. A phenomenon commonly referred to 'run-away production.' In addition to the international competition from Canada,

Australia and most EU nations, over 40 U.S. states offer meaningful financial incentives to the film industry successfully luring production and post-production jobs and spending away from California.

"In February 2009, the California Film & Television Tax Credit Program was enacted as part of a targeted economic stimulus package to increase production spending, jobs and tax revenues in California. AB 1069, in seeking a five-year extension to the existing law, acknowledges that the Program has been successful in its goal to retain and increase film and television production occurring in California."

California Motion Picture Tax Credit Program: Background. In February 2009, the California Film & Television Tax Credit Program (Film Tax Credit Program) was enacted as a part of an economic stimulus plan to promote production spending, jobs, and tax revenues in California. Although a bill creating some sort of a tax incentive for the motion picture and television production in California had been introduced almost every legislative session long prior to 2009, the existing film tax credit program was initially recommended by then Governor Schwarzenegger in his 2009-10 Budget proposal. Unlike other proposals in the past, the existing film tax credit is targeted, capped and allocated. In many respects, it is similar to a grant program. It is effective only for five fiscal years, from FY 2009-10 until FY 2013-14, and only \$500 million total is allocated to this credit over the life of the program. The CFC is required to allocate and certify the credit on the first-come first-serve basis, up to \$100 million every FY. The credit cannot be used until January 1, 2011, and is not refundable.

Is the Film Tax Credit Program effective in achieving the stated goal? With the current financial state of the California economy, all state programs affecting the General Fund are under scrutiny to ensure that the programs are effectively achieving desired results. The main goal of the Film Tax Credit Program is to prevent runaway production and retain production already being filmed in California. The Film Tax Credit Program is a relatively new program, and whether the program has been successful in achieving its main goal is up for debate.

Maybe it is. Undoubtedly, California companies face higher costs of doing business - land, labor, and capital are generally more expensive here. Furthermore, other states and foreign countries have been fiercely competing with California to lure motion picture and television series production away from California. The high costs of doing business in California, coupled with very generous tax incentives provided elsewhere, force many motion picture companies - that would otherwise seek to locate in California - to lower-cost and lower-tax jurisdictions. According to the CFC, in 2003, "66% of studio feature films were filmed in California." In 2009, however, only 38% of studio films were filmed in the state, and San Francisco film and TV production employment dropped 43% between 2001 and 2006.

The recent report released by the Milken Institute states that, although "it is still too early to know the real impacts of the Film Tax Credit Program, there are some encouraging signs" that the Film Tax Credit Program is working. (K. Klowden, A. Chatterjee, and C. Flor Hynek, *Film Flight: Lost Production and Its Economic Impact on California*, Milken Institute, July 2010). Thus, in January of 2010, the Los Angeles Economic Development Commission (LAEDC) projected that, as a result of the California incentive program, production in the state should have picked up in 2010. The projection by LAEDC was bolstered by Film L.A. (the permitting agency for Los Angeles) reports. Film L.A. reported that, in 2010, feature film production posted a 28.1% fourth quarter gain and a year-over-year gain of 8.1%. In Film L.A.'s January 11, 2011, release, it was reported that the increase can be wholly attributed to the Film Tax Credit Program. The Program attracted dozens of new feature film projects to Los Angeles, which was responsible for 26% of the local feature production for the year. The CFC

stated that these numbers are an early indicator that the incentive program is having an immediate positive impact on production in California.

The increase in production has resulted in increased revenues to the state as well as an increase in jobs. As reported by the CFC, in FY 2009-10, \$176 million in tax credits were allocated to 70 projects. The aggregate amount of direct spending by the 70 projects is estimated at \$1.2 billion, of which \$453 million is attributable to direct qualified wages (excluded any wages for actors, directors, writers, and producers), \$430 million to qualified non-wage expenditures, and \$346 million to non-qualified production expenditures (e.g., addition spending that does not qualify for tax credits). An estimated 18,200 crew and 4,000 cast members have been or will be hired by the approved projects and an additional 113,000 individuals will receive daily employment as background players. Further, in FY 2010-2011, \$121 million in tax credits were allocated to 43 projects. The estimated aggregate direct spending by the 43 projects is \$969 million. Over \$275 million is directly attributed to qualified wages and \$315 million to qualified non-wage expenditures. An estimated 7,500 crew and 2,100 cast members have been or will be hired by the approved projects and an additional 59,000 individuals will receive daily employment as background players.

To date, \$300 million in tax credits have been allocated which has resulted in a total aggregate of direct spending of \$2.2 billion and total wages paid/to be paid of \$728 million. It has been estimated, using generic multipliers for motion picture and video industries in California, that the broader economic impact of the Film Tax Credit Program has resulted in business revenues of \$6.5 billion, full time equivalent jobs of 40,996, and earnings of \$1.8 billion.

California has a comparative advantage over other states because of the long established entertainment industry. The established industry has provided California with a skilled workforce and available infrastructure. It has been argued that the comparative advantage, when coupled with an incentive program, should be effective in keeping production in California, despite the fact that the California tax credit is not as generous as that of other states. In other words, an incentive program that is less costly than those provided in other states has the ability to keep production in California because of the various other benefits connected with filming in California.

Maybe it is not. Critics, however, argue that the economic benefits of film tax credits are often overstated, "while their costs are underestimated or completely ignored." (M. Robyn, Tax Foundation, *Film Production Incentives: a Game California Shouldn't Play*, p. 1, A Report Presented at the Joint Oversight Hearing of the Committee on Revenue and Taxation and the Committee on Arts, Entertainment, Sports, Tourism, and Internet Media, March 21, 2011).

Although "industry advocates long have argued that movie production in California was in danger of being poached by other states or countries through their use of [motion picture tax incentives], employment and wage data for the motion picture industry do not provide clear evidence that any significant damage to the state's industry or economy has resulted from efforts by other states to draw movie production away from California in the past decade." (Brian R. Sala, Acting Director, California Research Bureau, *Updated Information On Film Industry Incentives*, a report presented on March 11, 2011, at the Joint Oversight Hearing of this Committee and Arts, Entertainment, Sports, Tourism, & Internet Media Committee). In fact, it appears that California's total film industry employment has grown since 2000, from 36% to 38%, though it has had its ups and downs (M. Robyn's Testimony, page 3).

Secondly, opponents argue that subsidies to the film and television industry benefit production that would have occurred in absence of the incentive and "much of the subsidy represents a real loss of

revenue with no net new jobs to offset the cost" (M. Robyn's Testimony, page 2). In its 2009-10 Budget Analysis Series, the Legislative Analyst Office (LAO) noted that the credit is allocated on a first-come first-serve basis, which undercuts the program's incentive for production companies to change their location decisions. The firms that are "absolutely committed to producing in California would be among the first to apply for credits – before firms that are considering an out-of-state location," and as a result, the credit "may be even more likely that most similar programs to create a windfall for committed in-state producers rather than be a deciding factor for otherwise-undecided producers" (2009-10 Budget Analysis Series, Film Production Credit, February 5, 2009). As noted by M. Robyn from Tax Foundation, in order for the film tax credit to be a revenue gain for the state, "any net new jobs, or net jobs saved, would have to generate enough tax revenue to outweigh the revenue wasted on productions that would have located in-state anyway" (M. Robyn's Testimony, page 2). However, no data is yet available to determine the extent of the film and TV production that would have occurred in the state in the last two years in the absence of the film tax credit.

The LAO was also concerned with a "horizontal inequity" created by this credit, meaning that similarly situated taxpayers are treated differently. The program is likely to create inequities in the way film companies are treated: some firms may be approved for credits, while other equally qualified firms may be denied simply because they did not apply soon enough.

Finally, the LAO report mentioned that it was unclear why "the film industry deserves special treatment" while other industries, for which production costs are higher in California than in some other locations, are left out. The LAO stated that the film tax credit, as proposed in 2009, would "arbitrarily favor some film producers over others" and that, rather than singling out individual industries, "the state should endeavor to create the conditions that permit all businesses to thrive." Even though film productions greatly impact the broader economy in California is not unique to the film industry; other industries have a similar effect.

The film and television industry has been a large source of employment and revenue for the state and losing the industry could be detrimental to the California economy. However, the question remains as to whether the value of the benefits received by the state from providing the film tax credit outweighs the costs of the tax subsidy.

What is the urgency? This bill proposes to extend the existing film tax credit program for an additional five years, from FY 2013-14 until FY 2018-19. In light of the fact that the existing program is not due to expire for another two years, and the fact that it is uncertain whether the existing tax credit is effective in achieving its goal, it may be prudent to postpone the consideration of the extension until next year, once more data is available.

Double-referral. This bill is double-referred with the Assembly Arts, Entertainment, Sports, Tourism, and Internet Media Committee and passed out of that committee with a 9-0 vote. For a more comprehensive analysis of this bill, please refer to that committee's analysis.

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