Date of Hearing: January 7, 2014

ASSEMBLY COMMITTEE ON ARTS, ENTERTAINMENT, SPORTS, TOURISM, AND INTERNET MEDIA
Ian C. Calderon, Chair

AB 286 (Nazarian) – As Amended: March 19, 2013

SUBJECT: Income taxes: credit: qualified motion pictures.

SUMMARY: This bill would expand the definition of qualified motion pictures under the film tax program for which the California Film Commission (CFC) annually allocates tax credits by removing the cap on the production budget for feature films and would limit the amount of qualified expenditures to $75 million, as specified. This bill would additionally revise the amount of credits allocated by the CFC per fiscal year for a qualifying television series, as specified, to provide that the minimum production budget threshold is met by allowing aggregation of two fiscal years expenditures. Specifically, this bill:

1) Declares that the allowable credit against the "net tax" for the production of a qualified motion picture in California of a picture that is a feature, as provided, shall not exceed $75 million. (See Existing Law for a detailed explanation of the film tax program.)

2) Removes the $75 million cap from the definition of "qualified motion pictures" for feature films eligible for the tax credit program.

3) Provides that for the 2013-14, 2014-15, and 2015-16 fiscal years, the CFC shall offset the aggregate amount of credits allocated to qualified motion pictures as specified, with an allocation amount from the next fiscal year so that the total aggregate amount of credits allocated meets the minimum $100 million requirement.

EXISTING LAW:

1) Establishes a motion picture production tax credit, equal to either:

   a) 20% of the qualified expenditures attributable to the production of a qualified motion picture, or;

   b) 25% of the qualified expenditures attributable to the production of a television series that relocated to California, or an independent film.

2) Defines "independent film" as a film with a budget between $1 million and $10 million produced by a non-publicly traded company which is not more than 25% owned by publicly traded companies.

3) Requires the CFC to administer a motion picture production tax credit allocation and certification program, as follows:

a) Taxpayers will first apply to the CFC for a credit allocation, based on a projected project budget.

b) Upon receiving an allocation, the project must be completed within 30 months.

c) The taxpayer must then provide the CFC with verification of completion and documentation of actual qualifying expenditures.

d) Based on that information, the CFC will issue the taxpayer a credit certificate up to the amount of the original allocation.

4) Defines "qualified motion pictures" as one produced for general distribution to the public, and include feature films with budgets between $1 million and $75 million; Movies of the Week with a minimum budget of $500,000, and new television series with a minimum production budget of $1 million licensed for basic cable and a television series that relocated to California.

5) Requires that in order to be eligible for the credit, 75% of the production days must take place within California or 75% of the production budget is incurred for payment for services performed within the state and the purchase or rental of property used within the state.

6) Declares that the credit is not available for commercial advertising, music videos, motion pictures for non-commercial use, news and public events programs, talk shows, game shows, reality programming, documentaries, and pornographic films.

7) Requires that the CFC allocate $100 million of credit authorizations each year during the period 2009-10 through 2017 on a first-come, first-served basis, with 10% of the allocation reserved for independent films.

8) Declares that any unallocated amounts and any allocation amounts in excess of certified credits may be carried over and reallocated by the CFC.

9) Provides that qualifying taxpayers could claim the credit on their tax return filed with the Franchise Tax Board (FTB) under either the Personal Income Tax or Corporation Tax.

10) Provides further that taxpayers may use certified credits in a number of ways, they may;

a) Claim it directly;

b) Assign it to another member of their unitary group;

c) Sell the credits to other taxpayers, or;

d) Elect to apply the credit against their sales and use tax liability.

FISCAL EFFECT: Unknown

COMMENTS:

1) Author's statement: According to the author, "The California Film & Television Tax Credit has been very successful in promoting direct spending and job growth." He points to the CFC's 2013 progress report, which reflects approximately $600 million in tax credits which have been allocated (reserved) to eligible film and TV projects, resulting in estimated total aggregate direct spending by Program projects of $4.75 billion and $1.48 billion in estimated total qualified wages paid/to be paid by Program projects.

   The author believes that the need to expand the program and create more flexibility is very evident as the CFC is flooded, on the first day the credit is made available, with hundreds of applications from independent and studio producers who want to produce in California. "Given that the California Film Tax Credit is exhausted on the first day, this bill will give the CFC more flexibility to issue available credits from the succeeding year and allow more projects to be awarded a credit," he asserts.

   Finally, the author states, "It is crucial in today's economy that the state provides the flexibility needed for the film industry to strive as this prosperous industry contributes $38 billion dollars annually to California's economy through tax revenue, jobs and tourism. In the last decade numerous foreign countries and more than 30 states have created generous and alluring film tax credits that regrettably threaten California's longstanding fruitful industry. Especially in California, where there is a long and rich history of entertainment business and growth, it is imperative that our state create competitive policies that offer meaningful financial incentives to retain and lure production, jobs and spending. AB 286's provisions provide the necessary economic stability to retain and attract film industry productions back to California by allowing big budget productions with a budget larger than $75 million to apply for a 20% tax credit for the first $75 million qualified expenditures and allowing the CFC to allocate credits from the succeeding year."

2) Current Film Production Tax Program: The California Film & Television Tax Credit program was enacted as a part of an economic stimulus plan to promote production spending, jobs, and tax revenues in California. The Program is administered by the CFC.

   The credit first became available in July of 2009. Under existing statute, a qualified taxpayer is allowed a credit against income and/or sales and use taxes based on qualified expenditures. The credit amounts to either 20% or 25% of qualified expenditures, with a maximum of $500 million dollars allocated total over the life of the program. The credit is not refundable. The credit may be carried over for five years and may be transferred to affiliates. Credits issued to independent films ($1 million - $10 million qualified expenditure budget that is produced by a company that is not publically traded and in which a publically traded company does not own more than 25% of the shares) may be transferred or sold to an unrelated party.

   To be eligible for the credit, a project must meet the 75% test (production days or total production budget in California) and must be a qualifying motion picture.

   For the purposes of a 20% tax credit, a qualifying motion picture is defined as:

   a) A Feature Film ($1 million minimum - $75 million maximum production budget),

b) A Movie of the Week or Miniseries ($500,000 minimum production budget); or

c) A new television series licensed for original distribution on basic cable ($1 million minimum budget, one-half hour shows and other exclusions apply)

For the purposes of a 25% tax credit, a qualifying motion picture is defined as:

e) A television series, without regard to episode length, that filmed all of its prior seasons outside of California; or

f) An independent film.

In the 2009-10 fiscal year, which was the initial year of the program, $200 million was allocated. In each subsequent year until the 2016-17 fiscal year, CFC will allocate $100 million. A minimum $10 million of the annual finding is made available for independent films.

3) Findings of Joint Oversight Hearings of Arts, Entertainment, Sports, Tourism and Internet Media (AEST&IM) and Revenue and Taxation Committees: The California Film Tax Credit has been intensely studied by this Committee and the Assembly Committee on Revenue and Taxation. On March 21, 2011, a Joint Oversight Hearing of the Assembly AEST&IM and the Assembly Revenue and Taxation Committees was held on "California's Film Credit Under the Spotlight: *A Review of the Film and Television Tax Credit Program."* Following this hearing, the Revenue and Taxation Committee held another Oversight Hearing "Assessing Tax Expenditure Programs in Light of California's Fiscal Challenges" on February 22, 2012, where the Film Tax Credit was again analyzed. Most recently, the two committees held another Joint Oversight Hearing, "A Review of the California Film Tax Credit Program," on October 9, 2013. The findings of these hearings regarding the effectiveness of the Tax Credit Program have been fairly consistent. The following was taken from the White Paper prepared for the October 9, 2013 Joint Hearing.

   a) Arguments of Program Proponents: A 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 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 would likely pick up in 2010. The projection by the LAEDC was bolstered by a report from Film L.A. (the permitting agency for Los Angeles). 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 could be wholly attributed to the Film Tax Credit Program. The Program attracted dozens of new feature film projects to Los Angeles, and was responsible for 26% of the local feature production for the year. According to the CFC, these numbers are an early indicator that the 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, approximately $600 million in tax credits,

including those conditionally allocated this year, has been allocated since the enactment of the Program. The total aggregate amount of direct spending is estimated to be $4.7 billion, of which an estimated $1.48 billion is attributable to qualified wages (excluding any wages for actors, directors, writers, and producers). Based on average aggregate spending by projects from each fiscal year, each $100 million of allocated tax credits will generate $792 million in direct production spending and cause productions to hire an estimated 8,500 cast and crew members. (CFC, *Progress Report*, July 2013).

Proponents also argue that California has a comparative advantage over other states because of its long established entertainment industry. This industry has provided California with a skilled workforce and ready infrastructure. It has been argued that this 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.

b) Arguments of Program Opponents: Despite the apparent success of increased film production and job growth, not everyone agrees with this use of state funds, raising several issues. Including, tax credits do not address the underlying issues (e.g., higher tax rates, regulatory impediments) that have led to California's sometimes challenging business climate. (San Jose Mercury News, *Hollywood tax break prompts debate over economy*, Tom Verdin, August 2012). Addressing these underlying issues, instead of allowing tax credits, may actually provide a more sustainable long term solution to the problem. In fact, according to a recent National Public Radio broadcast, "[s]tudies by think tanks across the political spectrum say states could get more bang for their buck with a general tax cut." (Julie Rose, *States Ponder Costs, Benefit of Film Incentives*, National Public Radio, Sept 2013). Additionally, having states compete against one another is an unsustainable downward spiral that may eventually cause California to spend more money than necessary to retain or lure production. As noted by the Tax Foundation, "subsidizing anything gets you more of that thing." The appropriate question, therefore, is not whether production is increased but "whether the benefits of a given amount of net new job creation and the net new investment exceed the cost." (Tax Foundation, *Important Questions to Ask in Evaluating a Film Tax Incentive Program*, March 2012).

Opponents have argued that subsidies to the film and television industry benefit production that would have occurred in the absence of the incentive and that "much of the subsidy represents a real loss of revenue with no net new jobs to offset the cost." (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 AEST&IM Committee, March 21, 2011). Furthermore, in its 2009-10 Budget Analysis Series, the LAO noted that the credit is allocated on a first-come first-served 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 than 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).

4) Opposition: The California School Employees Association oppose this bill, based upon their concern that, "Our schools have suffered from $20 billion in cuts over the past five years. Teachers and classified employees have been laid off by the tens of thousands and many more are furloughed. Every dollar we lose in state revenues means less funding for schools and other vital programs for seniors and children. The passage of Proposition 30 helped our schools and colleges avoid an additional $6 billion in cuts. These funds are meant to stabilize our schools, not to restore those cuts. While our schools struggle to recover from the devastating cuts, giving out more tax breaks to an industry known for their creative accounting goes in the wrong direction."

5) Implementation Issues With AB 286 Attempt to Expand Qualifying Television Series: This bill provides, that for the 2013-14, 2014-15, and 2015-16 fiscal years, the CFC shall offset the aggregate amount of credits allocated to qualified motion pictures defined pursuant to clauses (iii) and (v) of subparagraph (A) of paragraph (15) of subdivision (b) with an allocation amount from the next fiscal year so that the total aggregate amount of credits allocated to qualified motion pictures defined pursuant to clauses (i), (ii), and (iv) of subparagraph (A) of paragraph (15) of subdivision (b) meets the minimum $100 million required by subparagraph (A) of this paragraph.

   What these cross references refer to are found under the definition of "qualified motion picture," where (b)(15)(A)(iii) refers to, "A new television series produced in California with a minimum production budget of $1 million licensed for original distribution on basic cable." While (b)(15)(A)(v) refers to, "A television series that relocated to California," which the law defines as, "a television series, without regard to episode length or initial media exhibition, that filmed all of its prior season or seasons outside of California and for which the taxpayer certifies that the credit provided pursuant to this section is the primary reason for relocating to California."

   Under the existing law, there is no monetary threshold for a returning series to qualify for the film tax credit program. Therefore, inclusion of this category may cause confusion.

   More troubling is the workability of the proposal to allow aggregation of two fiscal years of expenditures for new cable television series, in order to reach the minimum production budget of one million dollars required to qualify for the film credit program. How is this to work? The concern is raised because of the high failure rate of television series, which 65% of all programs. (Ocasio [May 17, 2012], *TV Success Rate: 65% Of New Shows Will Be Canceled & Why It Matters,* Screenrant, http://screenrant.com/tv-success-rate-canceled-shows-aco-172162/2/).

   If the CFC must accept applications for low-budget series prior to their first year of production, it seems very likely that the finite resources of the CFC will be tied up in commitments to series which may never see the second year of production, and therefore never become "qualified motion pictures." Conversely, if a new series must wait until after the second year of production, or as the language of this bill puts it, "the next fiscal year," in order to present the CFC with their aggregated total expenditures, this would seem to thwart

the goal of the provision which is to encourage development of new California-based television programs.

6) Prior and Related Legislation:

a) AB 1189 (Nazarian) of the 2013-14 Legislative Session, would extend for five years the requirement that CFC annually allocate tax credits to qualifying motion pictures, as specified, through the 2021-22 fiscal year and would also extend and increase the limit on the aggregate amount of credits that may be allocated through the 2021-22 fiscal year. AB 1189 is pending hearing in this Committee.

b) AB 2026 (Fuentes), Chapter 841, Statutes of 2012, extended the film production tax credit program for two additional years, until 2017.

c) AB 1069 (Fuentes), Chapter 731, Statutes of 2011, extended the film production tax credit program for one year, until 2015.

d) SB 1197 (Calderon), of the 2009-10 Legislative Session, deleted the fiscal year limitation on the existing film production tax credit. SB 1197 was held in Senate Revenue & Taxation Committee without a hearing.

e) SBX8 55 (Calderon), of the 2009-10 Legislative Session, deleted the fiscal year limitation in the existing production tax credit. SBX8 55 was held in Senate Rules Committee without a hearing.

f) ABX3 15 (Krekorian), Chapter 10, Statutes of the 2009-10 Third Extraordinary Session, established a five year $500M tax credit for qualified expenditures on qualified productions. Limited allocations to $100M/year.

g) AB 855 (Krekorian), of the 2009-10 Legislative Session, established a film production tax credit. AB 855 was held at the Assembly Desk.

h) AB 1696 (Bass), of the 2007-08 Legislative Session, established a financial assistance program within the CFC to encourage filming motion pictures and commercials in California and requires the Business, Transportation & Housing Agency to report the economic impact of this program by December, 2011. AB 1696 failed passage on the Senate Floor.

i) SB 359 (Runner), of the 2007-08 Legislative Session, mega tax credit bill which included motion picture production credit. Part of State Budget negotiations. Created a credit for a percentage of the wages paid of amounts paid to purchase or lease tangible personal property in conjunction with the production of a qualified motion picture. The credit is certified and allocated by the CFC. The bill also allows the credit to be claimed against the sales and use tax liability of the company in lieu of the franchise or income tax liability. Finally, the bill allows the credit to be carried over until exhausted. SB 359 was held in the Senate Revenue and Taxation Committee.

j) AB 832 (Bass), of the 2007-08 Legislative Session, created unfunded grant program administered by the CFC to encourage filming motion pictures and commercials in

California. AB 832 was held on the Assembly Appropriations Committee Suspense File.

k) SB 740 (Calderon), of the 2007-08 Legislative Session, created a film production credit equal to 100% of the direct revenues attributable to the production or 125% of the revenues of the productions in a TV series that relocated to California or an independent film as defined. SB 740 was held in Senate Revenue & Taxation Committee without a hearing.

l) AB 777 (Nunez), of the 2005-06 Legislative Session, authorized qualified motion picture tax credit in an amount equal to 12% of the qualified production for qualified wages paid with an additional 3% for qualified motion pictures. Created refundable credit. AB 777 was held in Senate Revenue & Taxation Committee without a hearing.

m) SB 58 (Murray), of the 2005-06 Legislative Session, granted a refundable income or corporation tax credit equal to 15% of the amount of qualified wages paid and qualified property purchased in the production of a qualified motion picture. SB 58 was held in Senate Revenue & Taxation Committee.

n) AB 261 (Koretz), of the 2005-06 Legislative Session, re-established funding for the Film California First Program. AB 261 was a gut and amend out in the Assembly Rules Committee and became a transportation bill.

o) AB 1830 (Cohn), of the 2003-04 Legislative Session, authorized tax credits between 2006 and 2012 in an amount equal to 15% of qualified wages paid or incurred for services performed, with respect to the production of each qualified motion picture. AB 1830 was held in this Committee without a hearing.

p) AB 1277 (Cohn), Chapter 662, Statutes of 2003, transferred administrative authority over the CFC to the Business, Transportation & Housing Agency. This bill also created the Film California First Fund, administered by the CFC, which provided for reimbursements to local governments for their costs in issuing permits for local filming of motion pictures. In the last two state budget cycles, no General Fund monies have been appropriated to operate this program.

q) AB 2410 (Frommer), Chapter 1042, Statutes of 2002, required the CFC to report annually the number of motion picture starts that occurred within the State of California. The bill also required EDD to research and maintain data on film industry employment, to determine the economic impact of the film industry, to monitor film industry employment and activity and competing states and countries, to examine the ethnic diversity and representation of minorities in the entertainment industry, to review the effect of federal, state and local laws on the filmed entertainment industry and to report that information to the legislature biannually, provided that funds are appropriated by the legislature in the annual Budget Act for these purposes.

r) AB 2747 (Wesson), of the 2001-02 Legislative Session, provided a tax incentive to produce motion pictures within California. Would offer tax credits to productions with a total cost of qualified wages between $200,000 and $10 million for 15-25% of wages paid to qualified individuals during the taxable year with respect to qualified motion picture production depending on the area. For each motion picture, the maximum amount of wages per qualified individual that could be taken into account when

computing the credit was $25,000. AB 2747 failed passage in the Senate Appropriations Committee.

s) SB 2061 (Schiff), Chapter 700, Statutes of 2000, created the State Theatrical Arts Resources (STAR) partnership which offers surplus State property to filmmakers, where unused State properties, such as health facilities and vacant office structures, are available at no charge or "almost free" to filmmakers.

t) AB 358 (Wildman & Kuehl), of the 1999-2000 Legislative Session, provided a refundable income and corporation tax credit for 10% of eligible wages paid for motion pictures and TV programs produced in California. AB 358 was held on the Senate Appropriations Committee Suspense File.

u) AB 484 (Kuehl), Chapter 699, Statutes of 1999, created the Film California First program, housed at the California Film Commission to reimburse certain film costs incurred by a qualified production company when filming on public property, but which is currently unfunded.

7) Double-referral: Should this bill pass out of this committee, it will be re-referred to the Assembly Committee on Revenue and Taxation.

REGISTERED SUPPORT / OPPOSITION:

Support

Valley Industry and Commerce Association

Opposition

California School Employees Association

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