SB 976

Department of Legislative Services

2010 Session

FISCAL AND POLICY NOTE

Senate Bill 976 (Senator Colburn)
Budget and Taxation

Income Tax - Film Production Activity Credit

This bill converts the existing Film Production Rebate Program into a tax credit program that is not subject to an annual appropriation. The value of the subsidy to each qualifying company will increase from 25% to 28% of qualified costs. There is no maximum amount of credits that can be claimed in each year or by any one entity. The bill also alters several provisions related to eligibility and reporting requirements at the Department of Business and Economic Development (DBED).

The bill takes effect July 1, 2010, and applies to tax year 2010 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $11.0 million in FY 2011 due to tax credits claimed for eligible film production expenses. General fund expenditures decrease by $1.0 million in FY 2011 due to repeal of the film production rebate program. Future year revenues reflect estimated amount of credits awarded and claimed in each year, whereas expenditures reflect the elimination of the rebate program. Revenue losses may be significantly higher than estimated and may approach $100 million in any fiscal year.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($11.0)	($47.0)	($60.0)	($62.0)	($56.0)
GF Expenditure	($1.0)	($1.0)	($3.2)	($3.2)	($3.2)
Net Effect	($10.0)	($46.0)	($56.8)	($58.8)	($52.8)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Bill Summary: A film producer that meets the requirements of the bill and is approved by DBED will receive a tax credit equal to 28% of qualified film production costs incurred in the State. If the tax credit exceeds the total tax liability in the tax year, the film producer can claim a refund (direct payment from the State) in the amount of the excess. In order to qualify for the tax credit, the estimated total direct costs incurred in the State must exceed $500,000.

Total direct costs include: (1) employee wages and benefits; (2) fees for services; (3) expenses for acquiring or leasing property; and (4) any other expense necessary to carry out a film production. Total direct costs does not include any salary, wages, or other compensation for personal services of an individual who receives more than $1 million in salary, wages, or other compensation for personal services in connection with any film production activity.

The film producer must notify DBED of its intent to seek the tax credit before production begins. A film producer is also required to submit an application containing specified information, including a description of the activity; a detailed budget with estimated number of employees and estimated wages; anticipated dates for carrying out major elements of the film production activity; and any other information required by DBED. DBED may require that the information be verified by an independent auditor selected and paid for by the film production entity.

Film production activity is defined as the production of a film or video product that is intended for nationwide commercial distribution and includes a(n): feature film, television project; commercial; infomercial; corporate film; music video; digital project; animation project; or multimedia project. Film production does not include a: student film; noncommercial personal video; sports broadcast; broadcast of a live event; or talk show.

By January 1 of each year, DBED must report to the Governor and the General Assembly on the number of applicants and the number and amount of tax credit certificates issued in the prior year. DBED and the Comptroller's Office are required to jointly adopt regulations to implement the bill.

Current Law: Chapter 96 of 2005 established the Film Production Employer Wage Rebate Grant Program. To qualify for the rebate, a film production activity must be intended for nationwide distribution and have direct costs in the State of at least $500,000, which may include wages and benefits, fees for services, or any other necessary expense. Eligible activities include, but are not limited to, films, commercials, and animation projects. The rebate is not available to sports broadcasts, live events, talk shows, or student films. DBED must determine whether the producer of the production is eligible for the rebate.

Chapter 96 also established the Film Production Employer Wage Rebate Fund, which is used to make rebate grants and pay the administrative expenses of the fund. The fund consists of money appropriated by the State, repayment of defaulted grants, and any other money made available to it by DBED. In each fiscal year, the maximum amount of subsidy payments made by DBED is limited to the amount of money appropriated to the rebate fund.

Chapter 87 of 2007 altered the value of the subsidy received by a company *from* a rebate of 50% of the first $25,000 of each qualified employee's wages (up to a total maximum of $2 million), *to* a maximum of 25% of the direct costs of the film production activity. This does not apply to employees earning over $1 million for a production. Chapter 87 did not cap the total amount of the award to each company and provided that the actual amount disbursed is at the discretion of DBED.

By December 31 of each year, DBED must report to the Governor and the General Assembly on the rebates granted in the prior fiscal year. The report must include:

- the number of local technicians, actors, and extras hired;
- a list of companies doing business in the State that provided direct goods or services for film production activity, including hotels; and
- any information indicating economic benefits of the rebates.

In addition to the wage rebate program, Chapter 432 of 2000 exempts the sale of tangible personal property or a taxable service that is used directly in connection with a "film production activity" from the State sales and use tax. Tangible personal property or a taxable service include items such as film, camera equipment, vehicle rentals, lighting and stage equipment, and props. The film producer or production company must apply to DBED for certification of eligibility for the exemption. DBED issues certificates to production companies filming in Maryland that provide for a sales tax exemption for the goods described above.

Background: In response to incentives and cost advantages offered in other countries, a handful of states earlier this decade began offering subsidies in order to attract local film production. Competition among states and other countries has led to a proliferation of subsidy programs – about 40 states offer significant subsidies to the industry. In addition, states have increased the value of subsidies in this more competitive environment.

Although the film industry has expanded outside of California and New York, employment remains concentrated in these two states. About 58% of the industry's workforce remains in California, 16% are in New York, and 1% in Louisiana.

Maryland Film Industry and Subsidy Program

Exhibit 1 illustrates the estimated amount of film-related production (films, commercials, music videos, and television programs) occurring in Maryland and the amount of subsidy payments in fiscal 2006 through 2008. Except for fiscal 2006, the first year of the program, total film-related expenditures have not increased markedly under the rebate subsidy program. In fiscal 2008, expenditures totaled $40.3 million, about 3% higher than the average amount of expenditures for the four years prior to the program's inception.

Exhibit 1
Maryland Film-related Expenditures and Subsidy Payments
Fiscal 2002-2008
($ in Millions)

	2002	2003	2004	2005	2006	2007	2008
Films	$16.8	$29.7	$9.7	$10.0	$26.9	$6.6	$27.3
Television	9.8	21.0	16.9	13.3	35.9	12.7	2.4
Commercials	4.4	4.6	4.3	5.2	6.7	4.3	6.0
Other	3.3	2.7	3.8	2.1	3.2	9.0	4.6
Total	**$34.3**	**$58.0**	**$34.7**	**$30.5**	**$72.7**	**$32.6**	**$40.3**
Subsidy Payments	$0.0	$0.0	$0.0	$0.0	$4.0	$6.9	$4.0

Source: Maryland Film Office

The program received an appropriation of $4 million in fiscal 2009, which was reduced in October 2008 to $2.5 million. A grant offer for $1 million from fiscal 2007 was rescinded and the funds were transferred to the fiscal 2009 allocation, increasing total funding to $3.5 million. The proposed State budget includes $1.0 million in funding for the subsidy program in fiscal 2011. A recent report estimated that the film industry employed 2,200 individuals in the State; less than one-tenth of 1% of total nonfarm employment in the State. Although modest compared with other states, through fiscal 2011 a total of $19.0 million in subsidies will be paid – an annual average of $3.2 million. Although Maryland has numerous business tax incentives, few business tax credits are explicitly available to one particular industry. By comparison, an average of $6 million has been appropriated to the biotechnology investment tax credit. The State biotechnology industry employed over 26,000 individuals in 2007. Maryland faces fierce competition from other states that have dedicated substantial resources to establishing and maintaining a film industry. In 2004, production of the film *Annapolis* was relocated from Maryland to Pennsylvania in part because Philadelphia and Pennsylvania offered between $2 to $3 million in subsidies. In another example, Baltimore City was reportedly being considered as the site for the recent film *The Curious Case of Benjamin Button* before the State of Louisiana ultimately paid a $27.1 million subsidy to the film's production company.

Program Economic Impacts

Film subsidy proponents indicate that the programs create jobs and generate substantial economic benefits throughout the economy that could offset the cost of the subsidy payments. Opponents question the effectiveness of the programs and the appropriateness of subsidizing a private firm in one industry for its production and wage costs, particularly when states are facing significant fiscal deficits.

Several studies have concluded that state film subsidy programs offer sizable economic benefits through increased jobs and economic activity and that tax credits or subsidies "pay for themselves." Independent analyses have highlighted the difficult task of determining the full economic impact of film production subsidy programs and have identified several potential flaws in these studies and a failure to consider other important impacts.

A policy analyst for the Federal Reserve Bank of Boston noted some of the important considerations in analyzing the impact of the Connecticut film tax credit:

- Benefits associated with film tax credits cannot be measured simply by adding up the in-state production expenditures for projects receiving credits. Expenditures occurring in the state will have a "multiplier" or "ripple" effect that is often larger than the initial expenditures.
- Film production activity that was actually induced by a credit should be distinguished from activity that would have taken place even without the credit. Only economic activity stemming from induced film production should be attributed to the credit. In addition, some production expenditures induced by the credit such as salaries paid to out-of-state residents may not have multiplier effects.

- The estimated net cost of a credit program reflects the amount of tax credits approved minus any increased revenues and changes in state spending due to economic activity generated by the credit.
- Balanced budget requirements will require state governments to either cut spending or increase other taxes to offset tax credit revenue losses. These actions are likely to have negative multiplier effects that offset the economic benefits generated by the credit.

Studies that fail to consider these impacts will not accurately characterize the tax credit economic impacts. The uneven distribution of the film industry across states might pose additional challenges as it is not clear that a tax credit program in a state with a high industry concentration such as New York will have the same impact as a state with a limited industry base.

In addition, a significant portion of jobs created and of increased additional economic activity generated in each state is merely a reallocation of economic activity among states. According to the New York State Governor's Office for Motion Picture and TV Development, during the 12 months following July 2006, as the Connecticut, Rhode Island, Massachusetts, and Pennsylvania programs became fully functional, New York experienced a $750 million drop in feature film applications compared to the previous 12 months. During the same period, Connecticut alone experienced an increase in feature film production of approximately $400 million. Instead of film production activity taking place where it is most efficient to do so, film subsidies lead to an inefficient allocation of capital and labor among and within states. The net economic gain should also be measured against the effectiveness of alternative economic development strategies.

State Revenues: The bill converts the existing Film Production Rebate Program to a tax credit program that is not subject to an annual appropriation. There is no cap on the maximum amount of credits that can be awarded to one production or in aggregate. Legislative Services advises that converting the rebate program to a conventional tax credit program without a limit on the total amount of credits that can be awarded will significantly increase the uncertainty over the total impact and timing of the program's fiscal impact.

The Maryland Film Office estimates that the bill could be expected to generate $100 million in film production activity in Maryland in the first year and $150 million in subsequent years. Based on this information and tax credit programs in existing states, general fund revenues may decrease by $11 million in fiscal 2011, $47 million in fiscal 2012, and around $60 million annually beginning in fiscal 2013. This estimate also assumes that 60% of credits are claimed in the fiscal year in which they are earned with the remaining amount claimed in the following fiscal year. Revenue losses may be significantly higher than estimated and may approach $100 million in any fiscal year.

State Expenditures: Repealing the film production rebate program will eliminate general fund expenditures to the rebate program fund. It is assumed that if the bill passes any amount of money appropriated to the fund in fiscal 2011 will be rescinded through the budget process or the Board of Public Works. General fund expenditures will decrease by $1.0 million in fiscal 2011 and 2012 and by $3.2 million annually beginning in fiscal 2013.

Additional Information

Prior Introductions: SB 596 and HB 908 of 2009, similar bills, were not reported from the Senate Budget and Taxation Committee and House Ways and Means Committee, respectively.

Cross File: None.

Information Source(s): Department of Business and Economic Development, Comptroller's Office, Federal Reserve Bank of Boston, Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510