AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

ASSEMBLYMEMBER WENDY CARRILLO, CHAIR

TUESDAY, MARCH 21, 2023

1:30 PM – STATE CAPITOL, ROOM 447

PUBLIC COMMENT LINE: 877-692-8957 / ACCESS CODE: 131 54 47

INFORMATIONAL HEARING
California Film Tax Credit

I. Welcome and Introductions

II. Overview of the Governor's Proposal on the California Film Tax Credit
- Brian Uhler, Deputy Legislative Analyst: Economy, Taxes, and Labor, Legislative Analyst's Office
- Colleen Bell, Executive Director, California Film Commission (CFC)
- Nancy Rae Stone, Deputy Director, Film and TV Tax Credit Program, CFC
- Jacob Kirn, Staff Finance Budget Analyst, Department of Finance

III. Diversity Panel
- Congressman Joaquin Castro (TX-20), *Government Accountability Office (GAO): Workforce Diversity: Hispanic Workers Are Underrepresented in the Media, and More Data Are Needed for Federal Enforcement Efforts*
- Dr. Ana-Christina Ramón, Director of the Entertainment and Media Research Initiative (EMRI) UCLA Institute for Research on Labor and Employment (IRLE), *UCLA Hollywood Diversity Report*

IV. Stakeholder Panel
- Kathy Bañuelos, Senior Vice President, State Government Affairs, Motion Picture Association
- Alex Aguilar Jr., Business Manager/Sec-Treasurer, Laborers' International Union of North America (LiUNA!) Local 724, Entertainment Union Coalition
- Brigitta Romanov, Executive Director, Costume Designers Guild, Local 892 International Alliance of Theatrical Stage Employees (IATSE), Recording Secretary and Board Member, California IATSE Council
- Jeanette Volturno & Marcei Brown, Producers, CatchLight Studios, Co-founders of Crewvie

V. Members Questions and Comments

VI. Public Comment

VII. Adjourn

7730 FRANCHISE TAX BOARD

ISSUE 1: CALIFORNIA FILM TAX CREDIT

The Governor's budget proposes to extend the authority for the California Film Commission (Commission) to allocate, and for qualified taxpayers to claim, the California Motion Picture and Television Production Credit for an additional five years, beginning in 2025-26, commonly referred to as "Film and Tax Credit 4.0". The annual allocation would remain at $330 million per year, and makes the credit refundable, thereby allowing taxpayers with insufficient tax liability to utilize the credit.

In addition, the Governor's budget proposes amendments to the California Soundstage Filming Tax Credit and the Film and TV Tax Credit.

BACKGROUND

Governor's Proposal

Film and TV Tax Credit 4.0. The Governor's budget proposes to extend the film tax credit for an additional five years, from July 2025 to June 2030 with an annual allocation of $330 million.

Refundability. Unlike previous versions of the film tax credit, the Governor's budget proposes to make the film tax credit refundable. Production companies could receive a refund for a portion of their credits that exceed their tax liability. Specifically, a taxpayer may receive a refund equal to the lesser of: (1) 18 percent of the credit or (2) 90 percent of the portion of the credit exceeding their tax liability. A taxpayer electing to receive such a refund would forfeit a portion of their credit equal to the lesser of: (1) 2 percent of the credit or (2) 10 percent of the portion of the credit exceeding their tax liability.

Diversity Requirements. The Governor's proposal also includes diversity requirements that are similar to those that apply to productions filmed at new or renovated soundstages, with two key differences. First, whereas the soundstage requirement provides an additional 4 percent credit to productions that meet or make a good faith effort to meet their diversity goals, the Governor's proposal would subtract 4 percent from baseline credit for productions failing to do so. Second, the requirements do not apply to independent films with qualified expenditures less than $10 million.

Background

Film and TV Tax Credit 1.0. In 2009, the Legislature first established a credit for qualified motion picture productions in California by enacting two bills AB X3 15 (Krekorian), Chapter 10, Statutes of 2009 Third Extraordinary Session, and SB X3 15 (Calderon), Chapter 17, Statutes of 2009 Third Extraordinary Session, commonly referred to as the "Film and TV Tax Credit 1.0". These bills directed the Commission to annually allocate $100 million in credits until the 2012-13 and to allocate two years' worth of credits, totaling $200 million in the 2009-10.

In 2011, the Legislature extended the program for one year to 2014-15 [AB 1069 (Fuentes), Chapter 731, Statutes of 2011], and then extended the program for two additional years until 2016-17 [AB 2026 (Fuentes), Chapter 841, Statutes of 2012, and SB 1197 (Calderon), Chapter 840, Statutes of 2012]. The Commission last allocated the final $100 million authorized under the Film and TV Credit 1.0 on July 1, 2015.

Film and TV Tax Credit 2.0. In 2014, the Legislature enacted "Film and TV Tax Credit 2.0," which directed the Commission to allocate $230 million in credits in the 2015-16, and $330 million in credits each year through 2019-20 [AB 1839 (Gatto), Chapter 413, Statutes 2014]. The lower amount for the initial allocation reflected the $100 million yet to be allocated pursuant to the Film and TV Tax Credit 1.0.

Film and TV Tax Credit 3.0. In 2018, the Legislature enacted the Film and TV Tax Credit 3.0, authorizing the Commission to allocate $330 million in credits each year through 2024-25 [SB 871 (Budget and Fiscal Review Committee), Chapter 54, Statutes of 2018]. SB 871 allowed a credit equal to 20 percent or 25 percent of qualified expenditures for production of a qualified motion picture in California, with additional credits for qualified expenditures related to original photography, as defined. Additionally, SB 871 required applicants to submit a summary of their voluntary programs designed to increase the representation of minorities and women in certain job classifications and directed the Commission to establish the Career Pathways Training program, among other provisions.

Soundstage Tax Credit. The 2021 budget package included SB 144 (Portantino, Chapter 114, Statutes of 2021) which allocates $150 million in film tax credits for productions that are filmed at new or renovated soundstages. The credits are available for productions in 2022 through 2032. The Commission identifies and certifies qualified soundstage construction projects. Productions receiving credits under this program are required to submit a diversity workplan to the Commission. The diversity workplan is required to include goals that are broadly reflective of California’s population, in terms of race and gender. Those productions are eligible to receive an additional 4 percent tax credit if they meet or make a good faith effort to meet their diversity goals.

Comparison of California Film Tax Credit Programs

Program	First Film Tax Credit	"Program 2.0"	2018 Extension
Years in Effect	2009-2017	2015-2020	2020-2025
Amount per Year	$100 million	$330 million[a]	$330 million
Credit Allocation	Lottery	Jobs ratio score	Modified jobs ratio score
Allocation Categories	10 percent of total credits reserved for independent films	Credits allocated as follows: • 40% for TV projects • 35% for feature films • 20% for relocating TV series • 5% for independent films	Credits allocated as follows: • 40% for TV projects • 35% for feature films • 17% for relocating TV series • 8% for independent films
Credit Percentage	Base: 20% of qualified spending. • Independent films: 25% • Relocating TV series: 25%	Base: 20% of qualified spending, plus additional: • 5% of spending outside LA • 5% of visual effects • 5% of music scoring Independent films and relocating television: 25%	Base: 20% of qualified spending, plus additional: • 5% to 10% of spending outside LA (up to 30% total) • 5% of visual effects • Independent films and relocating television: 25%
Other Requirements		Complete "career readiness" requirement. Provide a statement that credit was a significant factor in choice of location.	In addition to the added requirements of Program 2.0, production companies must have a written policy against sexual harassment and provide a summary of programs to increase workplace diversity.

[a]Only $230 million was available in the first year of Program 2.0 because it was concurrent with the first credit.

Current Program Trends. According to the Department of Finance (DOF), over the lifetime of the program (1.0, 2.0 and 3.0), the Commission has allocated credits to 624 projects, including 185 that have applied as an independent production. This equates to about 30 companies per year who have received allocations. About 60 percent of all allocated credits have been certified and about 80 percent of credits certified so far have been claimed and used against income tax liability or sales tax liability.

The pace at which credits are certified has significantly slowed down over the most recent years, with just about 15 percent of credits allocated that have been certified from 2019-20 through 2022- 23. The share of credits used against sales tax liability (as opposed to being used against income tax) has steadily but drastically increased over the years, from an average of 15 percent of total credit usage in the first six years of the program to an average of 60 percent in the past three years.

According to the LAO, several other states have film tax credit programs that are more generous (and expensive) than California's. Whereas California caps film tax credit allocations at $330 million per year, some states—such as Georgia, Massachusetts, and Connecticut—do not have an annual cap on the amount of tax credits available to production companies. Similarly, while California's film tax credit is nonrefundable, more than ten states provide refundable credits. This means a taxpayer can claim more credits than their tax liability, allowing them to receive a refund.

Revenue Impact. According to DOF, most of the costs associated with the 4.0 program are incurred in future years of the timing of the extension as well as the need for productions to reach their milestones before being able to generate and certify credits. DOF estimates a revenue impact of $8 million in 2025- 26 and of $49 million in 2026-27 for the extension.

$ in Millions	2023-24	2024-25	2025-26	2026-27
Five-Year extension	$0.0	$0.0	$7.0	$43.0
Film tax credit refundability	$0.0	$0.0	$1.0	$6.0

LAO COMMENTS

The LAO recently released their report, *The 2023-24 Budget: California's Film Tax Credit, which* both provides an analysis of the Governor's proposal as well as meets their requirements to produce a report on the credit under Revenue and Taxation Code Section 38.9(a). In this report, the LAO discusses the advantages and disadvantages of refundability, and provides recommendations to the Legislature:

Refundable Credits Have Some Advantages… Making the film tax credit refundable could have some advantages:

- *Improved Taxpayer Equity.* With the current nonrefundable credit, a taxpayer's ability to claim the credit is tied to the amount of their state tax liability. This means their ability to claim credits can vary based on factors unrelated to motion picture production. For example, some taxpayers engage in other operations that result in sales tax liability, which allows them to claim additional credits. Similarly, some taxpayers may receive tax credits for other activities the state aims to encourage (such as research and development) which reduce their tax liability and limit their ability to claim film tax credits. Making the film tax credit refundable delinks credit claiming from tax liability and thereby lessens differential treatment of taxpayers.

- *More Appealing to Production Companies.* Refundable film tax credits would be more appealing to production companies. This is because it would allow companies to receive tax benefits sooner in many cases. The program is already fully subscribed, however, so increasing its appeal probably would not result in more productions taking advantage of the credit. However, refundability might change the composition of productions applying for and receiving credits. Some limited evidence suggests that refundable credits may be particularly appealing to larger production companies and productions with larger crews (Owens and Rennhoff [2020]). If so, this might further the goal of expanding the size of California's motion picture industry.

…But Also Disadvantages. However, the potential benefits of a refundable film tax credit should be weighed against several disadvantages:

- *Accelerated State Costs.* A primary advantage for the state of the film tax credit being nonrefundable is that it spreads state costs for the credit over several years. For instance, looking at the first film tax credit program, we see that most of the allocated credits were eventually claimed but only over the course of many years. If the credit were made refundable, state costs instead would be incurred more quickly.

- *Increased Costs.* In addition, overall state costs for the credit would increase if it were refundable. With a nonrefundable credit, some taxpayers never have enough tax liability, even over multiple years, to fully claim theirs credits. Because of this, the administration estimates that making the credit refundable would increase state costs for the proposed extension by a total of $200 million across multiple years.

- *Increased Administrative Complexity.* California currently does not have any refundable business tax credits. For this reason, the Franchise Tax Board's (FTB's) procedures are designed only to allow taxpayers to receive refunds for payments they have made. Making the film tax credit refundable would necessitate administrative changes at FTB that would result in additional costs and complexity. Consistent with this, the Governor's budget includes a request from FTB for $4.5 million in 2023-24 and seven positions to prepare itself to implement refundable business tax credits in general. FTB anticipates additional costs specific to administration of a refundable film tax credit.

- *Could Stoke "Race to the Bottom."* Ideally, the state would not feel a need to have a film tax credit to maintain its current motion picture industry. However, widespread competition from film tax credits in other states has caused the state to look to tax credits as a way to protect a prized industry. In this environment, a potential disadvantage of California adopting a refundable tax credit is that it could prompt competing states to further expand the generosity of their programs. This heightened interstate competition would be counterproductive to the film tax credit's goal of protecting Hollywood.

LAO Recommendations:

If Extending the Credit, Refundability Worth Considering but With Modifications. Ultimately, whether or not the Legislature approves the proposed extension of the film tax credit depends on how it weighs the importance of Hollywood against its various other priorities. If the Legislature elects to extend the credit, however, refundability is worth considering but with modifications. Specifically, we suggest several modifications to achieve some benefits of refundability while limiting the downsides. Taking these steps to contain costs could especially make sense in an environment where the Governor's budget anticipates shortfalls over the next several years.

Consider Making Fully Refundable. The Governor's proposed rules to limit the amount of film tax credits refunded each year are unnecessarily complex and would increase administrative burden for applicants and FTB. We think there are more straightforward methods to limit state costs while making the film tax credit fully refundable, which we discuss below. Further, the proposed restrictions on refundability would lessen the extent to which the policy change would improve taxpayer equity. The proposed restrictions could be binding on certain taxpayers for reasons unrelated to their motion picture production activities—such as whether or not they have significant sales tax liability. As such, we suggest the Legislature consider making the credit fully refundable, but only in combination with the additional suggestions below.

Specify a Schedule of Credit Claiming. As mentioned above, an advantage of the nonrefundable film tax credit is that it spreads state costs over several years. The state could maintain this benefit while making the credit refundable by specifying that the credit be claimed in equal increments over a number of years. A similar approach is used for other tax credit programs, such as the state's low-income housing tax credit. Spreading credit claiming over five years would achieve the same benefits as the Governor's proposal for partial refundability, but with less complexity.

Reduce Annual Credit Allocation for Cost Neutrality. The administration estimates that making the film tax credit refundable will increase total state costs by about 12 percent. An option to reduce this impact could be to reduce the annual allocation of credits commensurately, from $330 million to $290 million.

Eliminate Some Flexibilities in Claiming the Credit. Some flexibilities in claiming the film tax credit, such as allowing credits to be applied to sales tax liability or reassigned within a corporate filing group, primarily exist to lessen the constraint non-refundability creates for taxpayers. As such, these flexibilities become unnecessary if the credit is made refundable. Further, these flexibilities add to the administrative complexity of the credit. For this reason, we suggest eliminating these flexibilities if the credit is made refundable.

STAFF COMMENTS

Extending the film tax credit at the level of $330 million is consistent with actions taken by previous legislatures. However, there are a few decision points that the Legislature will have to consider with this tax extension:

- Whether to make the tax credit refundable, which is a significant change in policy from previous iterations of the tax credit. The Legislature will have to weigh the advantages and disadvantages of refundability.

- How to shape the credit to promote diversity opportunities in California's film industry.

The Subcommittee may wish to ask the following:

For Commission:

- Why is refundability important to the administration?

- Can you please explain the changes to the approach for diversity? Do the changes for the diversity workplans make the diversity approach stronger?

For DOF:

- Can you please explain the revenue impacts of refundability revenue impacts over at least the next decade?

- What are the economic benefits from California Film tax Credit?

Staff Recommendation: Hold Open.