SENATE COMMITTEE ON GOVERNANCE AND FINANCE
Senator Mike McGuire, Chair
2021 - 2022 Regular

Bill No:	SB 611	**Hearing Date:**	5/6/21
Author:	Allen	**Tax Levy:**	Yes
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Consultant:	Deitchman		

INCOME TAXES: CREDITS: MOTION PICTURES

Would allow an additional credit to the California Film and TV 3.0 tax credit program for those taxpayers that hire certain individuals.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something that but for the tax credit, they would otherwise not do. The Department of Finance is required annually to publish a list of state tax expenditures, currently totaling around $74.8 billion per year.

In 1985, the Legislature established the California Film Commission (CFC) to coordinate state and local governments' efforts at providing an environment conducive for the film industry. The Governor, the Senate Pro Tempore, and the Speaker of the Assembly appoint CFC's 21 members from the film industry, private sector, and state and local governments.

In 2009, the Legislature enacted a tax credit for qualified motion picture production in California, directing CFC to annually allocate $100 million in credits until the 2012-13 fiscal year, commonly known as "Film and TV Tax Credit 1.0" (SBx3 15, Calderon and ABx3 15, Krekorian, 2009). Both measures directed CFC to allocate two years' worth of credits ($200 million) in 2009-10, so CFC allocated the next year's credits for each fiscal year from 2010-11 onward. For example, when CFC allocated credits in July 1, 2014, the allocation was for credits authorized in FY 2015-16. In 2011, the Legislature extended the program for one year to 2014-15 (AB 1069, Fuentes), then extended it for two years until 2016-17 (AB 2026, Fuentes and SB 1197, Calderon). Because the initial bills directed CFC to allocate the next year's credits, CFC last allocated the last $100 million tranche of Film and TV Credit 1.0 on July 1, 2015.

In 2014, the Legislature enacted "Film and TV Tax Credit 2.0," which directed CFC to allocate $230 million in credits in 2015-16, and $330 million in credits each fiscal year through 2019-20 (AB 1839, Gatto); the lower initial amount reflected the $100 million remaining under Film and TV Credit 1.0. The Legislature designed Film and TV Tax Credit 1.0 and 2.0 in very similar ways, but with several key differences in credit mechanics, as well as the application and allocation process.

Credit mechanics. CFC can allocate credits to "qualified motion pictures," which must:

- Have 75% of the motion picture shooting days take place in California, or have 75% of the motion production budget incurred for services or the purchase or rental of property within the state;
- Commence principal photography within 180 days, and finish within 30 months from the date when the application was approved by the CFC; and
- Obtain a copyright from the United States Copyright Office.

CFC can allocate credits to any of the following productions:

- A feature with a minimum production budget of $1 million.
- A movie of the week or miniseries with a minimum production budget of $500,000.
- A new television series produced in California with a minimum production budget of $1 million.
- An independent film, as defined.
- A television series that relocated to California.
- A pilot for a new television series longer than 40 minutes of running time exclusive of commercials produced in California with a minimum production budget of $1 million.

Commercial advertising, music videos, motion pictures for non-commercial use, news and public events programs, talk shows, game shows, reality programming, documentaries, or sexually explicit films are not eligible.

The amount of the tax credit is equal to either:

- 20% of the qualified production expenditures for a feature, or, a television series that relocated to California in its second or subsequent season, or
- 25% of the qualified expenditures of an independent film, or for the first year that a television series that relocates to California.

Qualified expenditures are amounts paid or incurred to purchase, or lease, tangible personal property, wages, or services performed in the state, during the motion picture production in California. Qualified expenditures do not include amounts paid to writers, directors, music directors, music composers, music supervisors, producers, or performers, other than background actors.

Up to a maximum of 25%, Film and TV Credit 2.0 contained credit "uplifts" for 20% productions when they incurred qualified expenditures for:

- Filming outside the Los Angeles zone, as defined.
- Music scoring and music track recording expenditures
- Visual effects expenditures, where at least 75 percent or a minimum of $10 million is paid or incurred in California

The credit is nonrefundable and nontransferable, but taxpayers have three options if they do not have sufficient income tax liability to offset the credit: taxpayers with credits for independent films may sell the credit to not more than one unrelated party, who cannot subsequently resell it, so long as the taxpayer reports the sale along with specified information to the Franchise Tax

Board (FTB). Additionally, taxpayers can elect to apply credits to offset any sales and use tax liability, and obtain either a refund of previously paid taxes or an offset of future ones, according to procedures set forth in statute. Lastly, corporation taxpayers may assign the credit to one or more affiliates within their unitary groups if the credit exceeds their liability.

Any credit sold or assigned is subject to the same requirements as if they had originally received the credit. Taxpayers cannot sell or assign credits if another taxpayer claims them in the same taxable year.

Application Process. Applicants file an application to the CFC, along with information that includes the motion picture production budget, the number of production days, a financing plan for the production, the diversity of the workforce employed by the applicant, and any other information the CFC or FTB deems relevant. Taxpayers must also include the amount of qualified wages the taxpayer expects to pay, the amount of credit the taxpayer computes the production will receive using the appropriate percentages, and a statement establishing that the credit is a significant factor in the applicant's choice of location for the qualified motion picture. The statement must include information regarding whether the qualified motion picture is at risk of not being filmed, or specify the jurisdiction or jurisdictions in which the qualified motion picture will be located in the absence of the tax credit, and must be signed by an officer or executive of the applicant.

If approved, CFC issues the applicant a credit allocation letter indicating the amount of credit *reserved*, pending continuing eligibility and final documentation. The applicant must commence principal photography within 6 months, and finish within 30 months from the date when the application was approved by the CFC.

When the project is complete, the applicant must provide final documentation to CFC necessary to verify the qualified expenditures eligible for the credit and the applicable percentage, plus a copyright certificate. CFC then determines whether the project is still eligible for the credit, and if so, the amount of qualified expenditures, and the applicable credit percentage. State law provides that this amount can be less, but not more, than the one in the credit allocation letter. Before CFC issues a credit certificate, the applicant must report:

- If readily available, a list of the states, provinces, or other jurisdictions in which any member of the applicant's combined reporting group in the same business unit as the qualified taxpayer that, in the preceding calendar year, has produced a qualified motion picture intended for release in the United States market.
- Whether a qualified motion picture was awarded any financial incentive by the state, province, or other jurisdiction that was predicated on the performance of primary principal photography or postproduction in that location.

Additionally, CFC uses final documentation to recalculate the jobs ratio. Based on information received from the applicant, if CFC determines that the jobs ratio for a production other than independent film is reduced by more than 10%, CFC reduces the credit by that percentage. If the jobs ratio is reduced by more than 20%, CFC is barred from accepting an application from that taxpayer, or any taxpayer within its unitary group of corporations. For independent films, the jobs ratio must be reduced by more than 30% for a credit reduction to occur, with reduction equal the amount of reduction plus 10%. CFC does not reduce the jobs ratio when a taxpayer demonstrates that the difference is due to reasonable cause, as defined.

Upon completion of its determination, CFC issues the taxpayer a credit certificate, which can be applied beginning that taxable year. Generally, 12 and 24 months pass between receiving a credit allocation letter and obtaining a credit certificate, with more time passing before the taxpayer claims a credit, sells or assigns it, or carries it forward to a future taxable year, when the state incurs its fiscal impact.

In 2018, the Legislature enacted the Film and TV Credit 3.0 which authorizes the California Film Commission to allocate $330 million in tax credits each fiscal year from 2020-21 to 2024-25 (SB 878, Committee on Budget and Fiscal Review). Additionally, the new credit allows the credit in an amount equal to 20 percent or 25 percent of qualified expenditures for the production of a qualified motion picture in California, with additional credit amounts allowed, including for amounts equal to specific qualified expenditures and qualified wages relating to original photography, as specified.

SB 878 required applicants to include in their applications the applicant's voluntary programs to increase the representation of minorities and women in certain job classifications, and CFC to annually post on its website and make available for public release specific aggregated diversity-related information collected from an applicant.

The author would like to encourage the hiring of new graduates into the film industry by providing an additional credit to those taxpayers that hire individuals that complete the Career Pathways Assistant Director Program, or its equivalent program.

Proposed Law

Senate Bill 611 allows an additional credit for taxpayers awarded the current Film and TV credit, for hiring qualified individuals, equal to 20 percent of the qualified wages paid to those individuals. To qualify, these individuals must be graduates of the career pathways Training Program, or an equivalent program, approved by CFC. Additionally, the qualified motion picture must file a workforce development plan with and approved by the California Film Commission, and the qualified motion picture must pay qualified wages to a graduate of the Career Pathways Training program or equivalent program approved by the California Film Commission in at least 60 percent of the departments of the production.

SB 611 defines "qualified individual" to mean any individual who performs services during the production period in an activity related to the production of a qualified motion picture. Qualified individual cannot include either of the following:

- Any individual related to the qualified taxpayer as described the Internal Revenue Code.
- Any 5-percent owner, of the qualified taxpayer, as defined in the Internal Revenue Code.

Under the bill, "qualified wages" means any of the following:

- Any wages subject to withholding under Division 6 (commencing with Section 13000) of the Unemployment Insurance Code that were paid or incurred by any taxpayer involved in the production of a qualified motion picture with respect to a qualified individual for services performed on the qualified motion picture production within this state;
- The portion of any employee fringe benefits paid or incurred by any taxpayer involved in the production of the qualified motion picture that are properly allocable to qualified wage amounts;

- Any payments made to a qualified entity for services performed in this state by qualified individuals; or
- Remuneration paid to an independent contractor who is a qualified individual for services performed within this state by that qualified individual.

However, "qualified wages" cannot include any of the following:

- Expenses, including wages, related to new use, reuse, clip use, licensing, secondary markets, or residual compensation, or the creation of any ancillary product, including, but not limited to, a soundtrack album, toy, game, trailer, or teaser.
- Expenses, including wages, paid or incurred with respect to acquisition, development, turnaround, or any rights thereto.
- Expenses, including wages, related to financing, overhead, marketing, promotion, or distribution of a qualified motion picture.
- Expenses, including wages, paid per person per qualified motion picture for writers, directors, music directors, music composers, music supervisors, producers, and performers, other than background actors with no scripted lines.

State Revenue Impact

Pending.

Comments

1. Purpose of the bill. According to the author, "It is essential that California's entertainment industry lead by example, committing to diversity and inclusion in its workplace. SB 611 builds upon the industry's commitment to train and employ more Californians from underrepresented communities for the skilled jobs that comprise the motion picture and television production industry. Without requiring the expenditure of additional public dollars, it leverages the framework of our state's successful Film and Television Tax Credit Program to incentivize career pathways for individuals from historically disadvantaged communities.

Those who work on movie and TV sets are highly trained and skilled at their craft. They work project to project, with periods of unemployment between jobs. Without both craft and life skills training combined with experience, it is hard to succeed and even harder to establish a career. California Film and Television Tax Credit Program 3.0 created a training and outreach program targeting underrepresented communities in the Los Angeles area, laying the foundation for a programs statewide. Career Pathways provides both life skills and professional craft training for entry level positions in film and television production. It is aimed at attracting new and diverse talent; creating a pathway for a trained workforce to pursue careers in the entertainment industry. Upon successful completion of the training program, participants gain direct entry into the workforce. Similarly, the Directors Guild of America has an Assistant Director Training Program. Jointly sponsored by the DGA and the Alliance of Motion Picture and Television Producers, its provides on-the-job training to for participants to become Second Assistant Directors, with extensive paid, hands-on work experience on actual film and television projects. Trainees who successfully complete all the program's requirements are invited to join the Guild.

SB 611 catalyzes motion picture productions to hire graduates from such existing, successful training programs with proven track records providing individuals from historically disadvantaged communities meaningful opportunities to pursue and build a lasting career in the entertainment industry. And it accomplishes this within the framework of the existing Film and Television Tax Credit Program, without spending additional taxpayer dollars."

2. Revenue Loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for taxpayers. Since the Legislature enacts these items to accomplish some governmental purpose, which has a cost — in the form of foregone revenues — state law refers to them as "tax expenditures." SB 611 seeks to encourage the hiring of recent graduates trying to enter the film industry, but as a result, will result in less revenue for the General Fund. Without General Fund moneys, the government has less funding to pay for important public services such as education and public safety. As a result, the state will have to reduce spending or increase taxes to match the foregone revenue. The Committee may wish to consider whether SB 611 is worth the spending cuts or tax increases.

3. What do we know? Tax benefits directed at specific industries do two things. First, they reward behavior that would have occurred anyway. Some movie producers will hire recent graduates when they make movies or television shows in California without a tax credit. In these instances, the state receives no marginal benefit, and provides a windfall benefit to the motion picture or television producers at the cost of public services. Second, the bill will generate additional employment, wage payments, and economic activity resulting from movies and television shows produced in California that wouldn't have been made in California but for the credit: the incentive will lower production costs at the margin in amounts necessary for producers to choose California instead of somewhere else. A successful tax credit results in more economic activity at the margin than its windfall benefit, but no tax credit has yet conclusively demonstrated that its benefits outweigh its costs.

4. Peter, meet Paul. SB 611 allows additional credit to business that hire and pay certain individuals that have gone through a training program. This bill does not add additional funds to the total allocation amount that the CFC can allocate. The ability for some productions to receive higher credit allocations could result in fewer productions receiving the credit (or the same number of businesses receiving a smaller credit), because the cap would be reached sooner. The Committee may wish to consider whether this expansion to the credit would be worth reducing the number of business that will be able to claim the credit.

5. Section 41 shall not apply. SB 1335 (Leno, 2014), added Revenue and Taxation Code Section 41 to require that any bill introduced on or after January 1, 2015 that allows a new income tax credit to contain specific goals, purposes, and objectives that the tax credit will achieve. In addition, SB 1335 requires detailed performance indicators for the Legislature to use when measuring whether the tax credit meets the goals, purposes, and objectives. This bill, and the existing Film and TV credit, provides that Section 41 shall not apply to this credit. The Committee may wish to consider whether the exemption is appropriate in this case.

6. Let's be clear. The bill specifies that the qualified motion picture credit must pay qualified wages to a graduate of the career pathways training program in at least 60 percent of the departments of the production. However, it is unclear what this definition means. The Committee may wish to consider an amendment to clarify that 60 percent of the departments for each

production mush have at least one career pathways graduate in order to qualify for this additional credit.

7. The American Rescue Act of 2021. This federal act was signed into law by President Biden on March 11, 2021, which provided billions of dollars in aid to states and local governments. The Act requires funds to be used for specifically enumerated types of expenditures, and additionally contains language stating that funds cannot be used to cut state taxes either directly or indirectly:

> "*A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.*"

The Department of Treasury has yet to provide clear guidance regarding whether a state will lose funds allocated for aid if it enacts tax expenditures which result in a loss of revenue, like SB 611. The Committee may wish to consider the risk of losing federal aid funds resulting from enacting new tax expenditures.

Support and Opposition (5/3/21)

Support: California Iatse Council; California State Council of Laborers; California Teamsters Public Affairs Council; Hollywood Chamber of Commerce; Laborers Local 724; Motion Picture Association of America; Sag-aftra; State Building and Construction Trades Council of Ca; Teamsters Local 399

Opposition: None submitted

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