Fiscal Note

BILL # SB 1708

TITLE: motion picture production; tax credits

SPONSOR: Gowan

STATUS: Senate Engrossed

PREPARED BY: Hans Olofsson

Description

The bill would create a motion picture production income tax credit, beginning in Tax Year (TY) 2023. The credit program would be implemented and administered by the Arizona Commerce Authority (ACA). The bill would authorize ACA to pre-approve up to $150 million in refundable credits per calendar year. (Unlike a non-refundable credit, a refundable credit is not limited by the taxpayer's liability.)

Depending on a company's level of Qualified Production Costs (QPC), the "base" credit would vary between 15% and 20% of such costs, as shown in the table below.

Amount of Qualified Production Costs (QPC)	Credit
if ≤ $10,000,000	15.0%
if $10,000,001 to $34,999,999	17.5%
if ≥ $35,000,000	20.0%

In addition to the "base" credit, a motion picture production company would also be eligible for an additional credit of:
- 2.5% of QPC if it uses a qualified production facility or films "at a practical location" as defined under the bill
- 2.5% of QPC if the film is produced by a long-term tenant of the qualified production facility
- 2.5% of labor costs for Arizona residents holding positions other than actors, writers, directors, producers, or management.

The information above means that the maximum credit percentage that a company would be eligible for is 25% of QPC and 27% of certain resident labor costs. (Labor costs are included in QPC.)

Estimated Impact

We estimate that the bill will have two General Fund impacts:

1) A loss of General Fund revenue due to the tax credits. This loss could eventually be as great as the maximum $150 million permitted under the bill. During the 3-year budget forecast window, we anticipate that the credit usage would likely be less than half of the credit cap.

2) "Dynamic" revenues associated with the potential behavioral response of individuals and businesses to the proposed legislation may offset some of the revenue loss. To the extent that a reduction in tax liability incentivizes greater film production, we will experience more economic activity. As a result, state General Fund and other tax collections will increase from the direct and indirect impacts of greater film production. The economic impact would include any new production facilities that may be constructed to take advantage of the film credit. According to industry representatives, 2 large studio complexes could be built in Arizona if the bill is enacted.

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Based on the experience of other states, we anticipate that this dynamic revenue impact would be less than the cost of the tax credits for the foreseeable future. An Arizona-based study, however, projects that the dynamic revenues would exceed the cost of the program by year 8 of the tax credit.

Analysis

Currently, approximately 30 states offer film tax credits with a wide array of programs. As a result, we had difficulty creating a general comparison of SB 1708 to these other states. In certain aspects, SB 1708 may have easier qualifications. For example, SB 1708 does not require that a certain minimum amount be spent by a production company to qualify for the credit. Many other states impose such restrictions (e.g., in California, feature films and TV series must meet a minimum budget requirement of $1 million to be eligible for their film credit while Georgia has a $500,000 annual minimum expenditure threshold).

SB 1708 also appears to be more stringent with respect to other provisions. Under the bill, a company that produces a film at a location that does not use a qualified production facility is required to perform all preproduction, postproduction, and editing at an industry standard facility in Arizona, if available. Not all states have a similar requirement. Texas, for example, requires that no more than 60% of total production days be completed in the state.

Most of the other 30 film credit states reduce the cost of production by 20% to 30%, which is comparable to the proposed Arizona program. By itself, the magnitude of the tax credit does not appear to give Arizona a competitive advantage.

The construction of new studio complexes and the spending by production companies would have a direct economic impact on the state. The construction would lead to short term gains in Transaction Privilege Tax (TPT) and Individual Income Tax withholding collections, while the production spending would produce more ongoing revenue gains. In addition, there would also be indirect and induced economic impacts due to the "ripple effects" generated by such spending. Some of these impacts, however, would likely occur absent the credit. For example, local commercials that would have been filmed regardless of the bill would now receive a credit of at least 15% of their production costs.

Evaluations of film tax credits in other states show a varied range in terms of their economic and fiscal impact. The metric typically used is referred to as "return on investment" (ROI), and it is a measure of the ratio between state revenue generated by the incentive and the state credit cost. For example, if the state ROI is 0.20, the credit generates 20¢ in net new revenues for each $1 in credit given. This means that if the ROI is less than 1, the credit costs the state more than it generates in net new revenues. Conversely, if the ROI is equal to 1 or greater, the credit generates the same amount, or more revenues for the state than the cost of the credit.

In 2019, Pennsylvania's Independent Fiscal Office conducted an evaluation of their state's film tax credit. As part of their report, they also compiled the result of 14 film tax credit studies in 10 states over the last decade. (While Pennsylvania's analysis was broad based in approach, there are other economic studies outside of these 14.)

Among their findings was that the estimated ROI varied considerably depending on the type of entity that conducted the economic and fiscal impact analysis:

- Government agencies conducted the study in 6 states. The state ROI varied from 0.06 to 0.20;
- 6 states commissioned a private entity to conduct the study. In these circumstances, the ROI ranged from 0.13 to 0.51; and
- Private entities contracted through an industry representative in 2 states. One state had a ROI of 0.21 and the other had an ROI of 0.89.

Another finding of the Pennsylvania study is that most capped credit programs tend to authorize near the maximum allowable amount. While we think that the $150 million cap would be difficult to achieve in the first 3 years as the film industry develops in Arizona, the Pennsylvania study suggests that we could ultimately achieve that level.

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In addition, the Rounds Consulting Group (RCG) conducted an in-state analysis of the SB 1708 proposal. They forecast that the proposal's dynamic revenues would exceed the $150 million credit cost in year 8 for a ROI more than 1.0. While possible, those findings are not supported by the Pennsylvania analysis. (The RCG study also suggests that construction-related activity will generate state tax revenues in the first 2 years, but that no credits will be taken in those years.)

Local Government Impact

As with the General Fund impact, we are not able to determine the bill's impact on local governments.

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