Tax Credit Case Studies

The goal of many tax credits is to stimulate economic activity and encourage job growth. We have chosen to examine three such tax credits that cap forgone revenue, thus avoiding the criticism of other tax credits that they provide blank checks and are not evaluated to ensure efficacy.

Both the New Jobs Tax Credit and the California Film and Television Tax Credit are California specific and were enacted in 2009 as part of an extraordinary session budget trailer bill (AB 15 X3, Chapter 10, Statutes of 2009). AB 15 X3 also included elective single sales factor appointment provisions for taxpayers subject to the California Corporation Tax as part of the overall budget agreement. The Low-Income Housing Tax Credit conforms to federal law and is competitive and oversubscribed.

New Jobs Tax Credit

A temporary tax incentive for small businesses with 20 or fewer employees was enacted in 2009 to provide a $3,000 credit for each net increase in fulltime employees. The Franchise Tax Board administers the credit, which automatically expires when the aggregate amount of credits claimed by individual and small business taxpayers reaches $400 million.

The Franchise Tax Board reports that, as of December 31, 2011, 12,914 personal income tax and business entity returns had been filed, with cumulative hiring credits totaling only $76 million. At this rate, it could take several years for the existing $400 million cap to be reached absent significant growth in the economy. Last year, a number of bills were introduced seeking to expand, accelerate and otherwise modify this tax credit program. Although no modifications have been made to the original program, more proposals are anticipated this year. When this credit was enacted, it was projected that the bulk of the $400 million would be claimed during the first two tax years, with the remainder expended by year five.

With the national unemployment rate hovering above 8%, some have advocated job creation tax credits as a means of revitalizing the struggling economy. The question, however, is whether such credits actually work. Recently, Daniel Wilson, assistant director of the Center for the Study of Innovation and Productivity at the Federal Reserve Bank of San Francisco, attempted to answer this question. In a paper co-authored with Robert Chirinko of the University of Illinois at Chicago, Wilson

examined the period between January 1990 and August 2009, and found that, among states where employers could qualify for credits immediately after enactment of the credit legislation, there was a slight employment increase of 0.12%. These findings along with the under-utilization of the New Jobs Credit suggest that hiring credits, at least at the state level, might be better formulated to stimulate job growth.

California Film and Television Tax Credit

The California Film Commission (CFC) administers this tax credit allocation and certification program on a noncompetitive basis. This program first became available in July of 2009 and unless extended, will sunset on July 1, 2014. In the 2009-10 fiscal year, $200 million of the maximum $500 million was allocated, leaving the remainder to be allocated at $100 million per year for three subsequent years. A minimum of $10 million of the annual funding is required to be spent on independent films.

This program offers flexibility for taxpayers by allowing them to use the certified credits in a variety of ways. The credit may be claimed directly, applied as a credit against sales and use tax liabilities, assigned to an affiliate, or in the case of independent productions, sold to other taxpayers.

The credit amounts to either 20% or 25% of qualified expenditures and the project must be completed within 30 months and meet the 75% test for production days or total production budget in California.

Qualifying motion pictures eligible to receive the 20% credit include feature films, movies of the week, miniseries and new television series. Motion pictures eligible to receive the 25% tax credit include television series that filmed all their prior seasons outside of California and independent films. The credit is not available for commercial advertising, music videos, talk shows, game shows, reality programing, documentaries or pornographic films.

The taxpayer must provide the CFC with verification and documentation of the actual qualifying expenditures to receive a credit certification.

The goal of the credit is to prevent runaway production and retain production in California. The LAO has criticized the distribution method of the credit, which was initially made available through a lottery of those who applied on the first day, arguing that projects already committed to production in California applied for the credits before other projects could have considered filming or staying in California. The LAO has also expressed concerns about inequity resulting from the different

treatment of similar taxpayers and the ability to transfer credits to non-film industry taxpayers.

To date, the CFC reports that, $300 million in tax credits have been allocated to 113 projects representing $2.2 billion in total film and television project spending. CFC estimates that 25,700 crew and 5,100 cast members have or will be hired by the approved projects and an additional 172,000 individuals will receive daily employment as background players. The CFC estimates the broader economic impact of the credit to be $6.5 billion in business revenues and over 40,000 fulltime jobs.

Low-Income Housing Tax Credit (LIHTC)

The California Tax Credit Allocation Committee (CTCAC), comprised of the State Treasurer, State Controller and Director of the Department of Finance, administers the state and federal low-income housing tax credits. All projects receiving the California credit must also receive the parallel federal credit.

This program is ongoing, but capped in statute, currently at approximately $101 million per year. Projects are awarded competitively based on specific standards and criteria developed by CTCAC. Projects using these credits are rent-restricted and must be occupied by a certain percentage of low-income occupants. This credit continues to be oversubscribed with over $200 million in applications every year.

This program provides an incentive for investors to fund affordable housing projects by awarding tax credits to developers who, in turn, sell them to investors in exchange for project funding. According to the Department of Finance, 400 individuals and business taxpayers claimed this credit in the 2008 tax year.

Many successful affordable housing projects are pieced together with a variety of local, state, and federal funding sources. The elimination of California's Redevelopment Agencies and affordable housing set-asides will have an effect on California projects. Housing advocates argue in favor of preserving some of the set-asides and potentially increasing this credit to continue attracting investors.

For example, the Mid-Peninsula Housing Coalition in South San Francisco has received a combination of funding to build 46 affordable large family units with facilities to provide adult education and after school children's programs. The state tax credit provided $1.7 million to this $20 million project. In 2010, CTCAC federal and state credits helped finance 8,616 low-income rental unit.