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Assembly Committees on Arts, Entertainment, Sports, Tourism, and Internet Media, and Revenue and Taxation

Joint Hearing: The Secondary Impact of California's Film and Television Tax Credit Program: Diversity?

California's Film and Television Tax Credit Program – Overview of Program 2.0

In 2014, Assembly Bill 1839 was signed into law to restructure California's existing Film and Television (TV) Tax Credit Program, a program that originally launched in 2009 as part of an economic stimulus plan to promote production spending, jobs, and increased tax revenues in California. In crafting California's new and expanded Film & Television Tax Credit Program 2.0 (Program 2.0) to be more robust and efficient, the Legislature, in its findings and declarations, stated that "California's tax credits for film and television must be reformed to ensure that California's taxpayers receive the maximum possible economic return on their investment."

Program 2.0 allocates up to $330 million in tax credits annually through and including the 2019-20 fiscal year, and allows a wider range of film and television projects to qualify as applicants for the tax credit, such as big-budget feature films, TV pilots, and one-hour TV series for any distribution outlet. Program 2.0 also replaced the original program's lottery system of allocating credits with a more competitive and accountable system that ranks tax credit applications according to net new jobs created and overall positive and sustained economic impacts throughout all of California. These program reforms were intended to expand utilization of the credit to combat film and TV production flight to other states and countries with generous tax incentives, thereby keeping jobs, tax revenue, local spending, and other economic benefits in California. The Legislative Analyst's Office (LAO) is required to provide a report to the Legislature evaluating the economic effects and administration of the tax credit by July 1, 2019.

Scope of the Tax Credit

Program 2.0 allows a *qualified taxpayer*, under both the Personal Income Tax Law and the Corporation Tax Law, a credit in an amount equal to 20 percent or 25 percent, as specified, of the *qualified expenditures* for the production of a *qualified motion picture* in California.

A "qualified motion picture" is a motion picture that is produced for distribution to the general public, regardless of medium, for which at least 75 percent of the principal photography days occur wholly in California or 75 percent of the production budget incurred goes toward payment for services performed or property used within California. A qualified motion picture must also be one of the following: a non-independent feature film, independent film, movie of the week, miniseries, TV series that relocated to California, or a new TV series or pilot for a new TV series of episodes longer than 40 minutes, as specified.

"Qualified expenditures" include:

a) Amounts paid or incurred for tangible personal property purchased or leased, and used, within California in the production of a qualified motion picture; and,

b) Payments, including *qualified wages*, for services performed within this state in the production of a qualified motion picture.

"Qualified wages" include wages paid or incurred by any taxpayer involved in the production of a qualified motion picture for services performed by an individual, as specified. However, qualified wages do not include:

a) Wages related to creation of ancillary products such as a soundtrack album or trailer, acquisition and development, or marketing and distribution; and,

b) Wages paid for writers, directors, music directors, music composers, music supervisors, producers, and performers, other than background actors with no scripted lines.

As such, the direct effect of the tax credit program on job creation and retention is generally felt by "below-the-line" workers on production sets, such as animal handlers, costume designers, grips, make-up artists, sound technicians, and studio transportation drivers.

Claiming the Tax Credit

A "qualified taxpayer" eligible for the Program 2.0 tax credit is a taxpayer who has paid or incurred qualified expenditures, participated in the Career Readiness requirement, and has been issued a credit certificate by the California Film Commission (CFC).

To apply for the tax credit, the qualified taxpayer must provide the CFC with statutorily required information such as the production budget, the amount of qualified wages the applicant expects to pay, the amount of tax credit the applicant computes the qualified motion picture will receive, and a statement establishing that the tax credit is a significant factor in the applicant's choice of location for the qualified motion picture. The applicant must also include, *to the extent possible*, information regarding the diversity of the workforce employed by the applicant during production of the qualified motion picture.

As stated in the CFC's October 2016 Progress Report, the CFC reviews applications to assess each project's eligibility for the credit based on its Jobs Ratio score. The Jobs Ratio score is determined by the amount of qualified wages and specified non-wage spending the project will generate, divided by the amount of tax credits estimated to be allocated. Bonus points may be accrued if the project meets criteria developed by the CFC intended to measure increased economic activity in California, such as in-state spending on visual effects, filming outside the Los Angeles 30-mile zone, and filming at approved production facilities.

Applications are then ranked from highest to lowest against "like" projects (for example, TV projects against TV projects) according to their Jobs Ratio score. The highest ranked projects receive a conditional allocation of tax credits from a dedicated funding "bucket," as follows, until all available credits for the application period are exhausted, and with the CFC authorized to increase or decrease a bucket's allocation amount by five percent in response to outsized demand for a specific credit category:

a) Five percent allocation for independent films;

b) 35 percent allocation for non-independent feature films;

c) 20 percent allocation for relocating TV series; and,

d) 40 percent allocation for new TV series, pilots for a new TV series, movies of the week, miniseries, and recurring TV series.

In addition to documenting a Jobs Ratio score with the CFC, all qualifying applicants must participate in career-based learning and training programs to meet the Career Readiness requirement unique to Program 2.0. There are many ways applicants can meet this requirement:

a) Paid Internship – provide high school or community college students either: (i) three paid internship positions with a minimum of 75 hours each, or (ii) a combination of internships with a minimum of 75 hours per student and a total of 225 hours overall. Internship experience should include hands-on work assignments with industry professionals.

b) Classroom Workshop – provide high school or community college students at least eight hours of classroom workshops or demonstrations on aspects of the film industry, including set operations, post-production, and technical crafts.

c) Studio Employment and Professional Skills Tour – provide high school or community college students at least eight hours of studio employment and professional skills tours, which may include set visits or tours of wardrobe, art, and editorial departments.

d) Faculty Externship – provide at least eight hours of continuing education for faculty to observe set operations, post-production, and other specialized departments.

e) Financial Contribution – provide a financial contribution, based on 0.25 percent of the applicant's estimated tax credit allocation with a minimum of $5,000 and maximum of $12,000, to a local education agency or higher education institution specializing in arts, media, and entertainment career-oriented programs.

According to the CFC's October 2016 Progress Report, many applicants have satisfied the Career Readiness requirement by providing paid internships or making a financial contribution to high school or community college funds. High school funds have provided scholarships to the 2016 California State Summer School for the Arts, a rigorous month-long training program for high school students in visual and performing arts, creative writing, animation, and film in preparation for a career in the arts and entertainment industries. Community college funds have been used to provide paid internships for students studying arts, media, or entertainment.

Only after all required documentation is submitted to the CFC, post-production is completed, and the project's Jobs Ratio score is verified can the applicant receive a tax credit certificate that allows the qualified taxpayer to claim the credit in the taxable year the certificate is issued. If a project's recomputed post-production Jobs Ratio score is lower than the estimated Jobs Ratio score at the time of application, the amount of credit allowed to the qualified taxpayer will be reduced, as specified, unless the CFC determines that there is reasonable cause for the reduction.

Impact of the Tax Credit on Economic Activity and Jobs

In its September 2016 review of California's original Film and TV Tax Credit Program, the LAO found that one-third of the film and TV projects receiving incentives under the program would probably have been made in California even without the credit, but that this level of "windfall benefits" to some credit recipients may be low in comparison to other tax credits. The LAO estimated that the $800 million in credits allowed under the original program will support over 350 projects, generate about $4.5 billion in new production spending by tax credit recipients, and likely be offset by several hundred million dollars of additional state and local tax revenues related to increased economic activity from film and TV production in California.

According to the CFC's October 2016 Progress Report, a total of approximately $675 million in credits have been allocated under the original tax credit program, resulting in total aggregate direct spending in California of $5.5 billion, including an estimated $1.9 billion spent on qualified wages and $1.3 billion spent on qualified non-wages. The report also found that $3.7 billion (84 percent) of production spending by projects on the waitlist for, but ultimately denied, a tax credit eventually occurred outside of California. Of these 164 "runaway" projects, all but two filmed in jurisdictions that offered tax credits.

Other reports have also concluded that the original tax credit program encouraged in-state film production and economic activity. For example, a March 2014 analysis by the Los Angeles Economic Development Corporation (commissioned by the Southern California Association of Governments) found that $1.11 was returned to local and state governments for each dollar of tax credit certificate issued. Furthermore, the analysis estimated that the tax credit program, in its first three fiscal years of funding, generated $4.3 billion in economic output and supported 22,300 jobs with labor income of $1.6 billion and state and local tax revenue of almost $248 million. However, critics of the program generally argue that the tax credit results in a subsidy to the industry that overstates the economic benefits of the program while underestimating costs.[1]

With regard to Program 2.0, the CFC's October 2016 Progress Report stated that approximately $230 million[2] in tax credits were allocated to 55 film and TV projects during fiscal year 2015-16. These projects are estimated to result in $1.5 billion in direct in-state spending, including $600 million spent on qualified wages and $410 million spent on qualified non-wages. The report also states that members of California's below-the-line unions worked 12.45% more hours in the first quarter of 2016 than in the same quarter of 2015.

Nexus between the Tax Credit and Diversity in the Film and TV Industry?

Data indicates, and individuals within the film and TV industry itself have acknowledged, that improvements could be made to increase diversity across a wide range of jobs in the industry. For example, the 2016 Comprehensive Annenberg Report on Diversity, which assessed inclusion on screen and behind the camera in fictional films, TV shows, and digital series by 10 major media companies, found that over 50 percent of stories featured no Asian speaking characters and 22 percent featured no African American characters. Diversity below-the-line has not been analyzed or evaluated to the same extent as diversity above-the-line, but accounts similarly reveal that more can be done to increase representation within the ranks.

In 2008, Illinois enacted a film tax credit of 30 percent of all qualified expenditures that also explicitly aims to stimulate diversity in production hiring. Film tax credit applicants must submit a Diversity Plan that details how they propose to ensure employment of a diverse crew that is representative of the state, and document "good faith efforts" to carry out the plan. An applicant may be denied the tax credit if the production has low racial or gender diversity on crew. Applicants also receive an additional 15 percent tax credit on salaries of individuals, as specified, that live in an economically disadvantaged area with at least 13.8 percent unemployment. In 2016, legislators in New York considered setting aside $5 million of the state's existing $420 million tax credit for TV productions to promote diversity amongst writers and directors. The legislation would have qualified minority or women TV writers' and directors' salaries, as specified, as "eligible costs" to be covered by the tax credit, but was not enacted.

Although both the original California program and Program 2.0 require tax credit applicants to report, *to the extent possible*, the diversity of their workforce, there is no specific language in the statutes enacting either tax credit program suggesting that a goal of the program is to increase workforce diversity in the film and TV industry. It is also important to underscore that published

[1] M. Robyn, Tax Foundation, *Film Production Incentives: A Game California Shouldn't Play*, a report presented at the Joint Oversight Hearing of the Committee on Revenue and Taxation and the Committee on Arts, Entertainment, Sports, Tourism, and Internet Media, March 21, 2011.

[2] Only $230 million in tax credits was allocated under Program 2.0 for fiscal year 2015-16 (instead of $330 million) because $100 million in tax credits was already reserved to be allocated under the original Film and TV Tax Credit Program expiring that year.

reports about diversity in the industry do not necessarily correlate with the demographics of productions that benefit from the tax credit as the credit only reaches a small segment of film and TV projects.

While both tax credit programs were structured to support below-the-line jobs in California, any increased production activity in California ultimately results in more in-state, above-the-line work and economic stimulus as well. To the extent that the tax credit program is a tax expenditure that decreases state funding for other public programs, but the state revenue loss is arguably offset because the expenditure provides economic expansion and job growth in California, it is important that such benefits reach all Californians, including those in disadvantaged and underrepresented communities.

Purpose of This Hearing

Now that Program 2.0 has concluded its first year of operation, this joint informational hearing seeks to better understand the economic impact of the tax credit. In particular, this hearing will explore whether a secondary impact of the tax credit has been to increase diversity in employment in the film and television industry, both above and below the line. As existing jobs are retained and new jobs are created in California, it is important to evaluate whether these jobs are reaching a diverse cross-section of communities and whether Program 2.0 is generating the maximum possible economic return on investment for all California taxpayers.