



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	<b>02/23/07</b>	Bill No:	<b><a href="#">SB 740</a></b>
Tax:	<b>Sales and Use</b>	Author:	<b>Calderon</b>
Related Bills:			

### BILL SUMMARY

This bill would authorize an income tax credit equal to 12% of the qualified amount for qualified wages or qualified property, as defined, paid or incurred during the production period of a qualified motion picture production, as specified and defined.

In lieu of claiming that credit, the bill would allow qualified taxpayers to claim either a refund of sales or use tax paid under the Sales and Use Tax Law, or a credit against a sales or use tax liability due, that is equal to the income tax credit amount that would otherwise be allowed pursuant to the income tax laws.

### ANALYSIS

#### CURRENT LAW

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property in this state. The use tax is imposed on the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless that property is specifically exempted.

With regard to the motion picture industry, the Sales and Use Tax Law provides the following:

- Section 6378 of the Sales and Use Tax Law provides an exemption from the 5.25 percent state sales and use tax, for the sale and purchase of any tangible personal property purchased for use *primarily* in teleproduction or other post production services, as described, by a qualified person that is *primarily* engaged in teleproduction or post production activities, as defined in Code 512191 of the North American Industry Classification System Manual, published by the United States Office of Management and Budget, 1997 edition.
- Section 6010.4 provides that when certain persons form partnerships to reduce the cost of producing motion pictures through the sharing of the use of equipment and other assets, the furnishing of that property, without the transfer of title, by the partnership to its members for the purpose of producing motion pictures by its members does not constitute a “sale” or a “purchase” and, therefore, no tax applies to the furnishing of that property.
- Section 6010.6 provides that “sale” and “purchase” do not include the following: 1) any transfer of any qualified motion picture, or any interest or rights therein, when

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the transfer is prior to the date that the qualified motion picture is exhibited or broadcast to its general audience, and 2) the performance of qualified production services, as defined, in connection with the production of any qualified motion picture, as defined. Therefore, no tax applies to these transactions.

- Sections 6006 and 6010 provide that leases of motion pictures or animated motion pictures, including television, films, and tapes, (except video cassettes, tapes, and discs leased for private use under which the lessee does not obtain the right to license or broadcast) do not constitute “sales” or “purchases.” Therefore, no tax applies to these transactions.

#### **PROPOSED LAW**

This bill would, among other things, add Section 6902.5 to the Sales and Use Tax Law, Section 17053.85 to the Personal Income Tax Law, and Section 23685 to the Corporation Tax Law, to do, among other things, the following:

1. Allow a credit to a qualified taxpayer against the personal income tax or the corporation tax an amount equal to 12 percent of the qualified amount, not to exceed \$3 million per qualified motion picture.
2. Define “qualified taxpayer” as an applicant who has been allocated tax credits by the California Film Commission (CFC).
3. Define “qualified amount” as the total amount paid or incurred after 01/01/07 during the production period for qualified wages and qualified property with respect to the production of each qualified motion picture.
4. Define “qualified property” as tangible personal property purchased or leased in California and used primarily in the production of a qualified motion picture.
5. Define “qualified motion picture” to mean, among other things, a feature, a movie of the week, or a mini series with a minimum budget of \$500,000 and a maximum budget of \$75 million, or a single episode in a single season, not to exceed 22 episodes per season, of a television series new to California with a minimum budget of \$500,000 and a maximum budget of \$1.8 million per episode, as specified.
6. Require the CFC to determine and designate who is a qualified taxpayer and allocate tax credits up to an unspecified amount to qualified taxpayers, as provided.
7. Until January 1, 2018, allow qualified taxpayers, in lieu of claiming the above credit, to either claim a refund of sales or use tax paid under the Sales and Use Tax Law, or claim a credit against liability for sales or use tax due, that is equal to the credit amount that would otherwise be allowed under Sections 17053.85 or 23685.

As a tax levy, the bill would become effective immediately.

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## BACKGROUND

Two similar measures were introduced in the 2005-06 Legislative Session: AB 777 (Nunez) which, as amended on August 17, 2005, would have provided a similar 12 percent credit, and SB 58 (Murray and Pavley), which would have provided a 15 percent credit. AB 777, as amended on August 17, 2005 was never heard in committee, and SB 58 died in the Senate Revenue and Taxation Committee.

## COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the author to create incentives in the law to discourage the practice of producing and filming motion pictures and commercials outside California.
2. **This analysis focuses primarily on the provisions contained in proposed Section 6902.5 which would fall under the Board's purview.** Some implementation concerns are noted below:
  - **Shouldn't the Franchise Tax Board (FTB) administer the refunds?** The Board would be required to make refunds or approve credits based on provisions administered by the FTB. Since the FTB has the expertise in administering the Personal Income Tax Law and the Corporation Tax Law, it appears more appropriate to retain administration of this credit mechanism within that agency.
  - **The bill should define "sales or use taxes paid."** The bill would allow a qualified taxpayer to claim a refund for sales or use taxes paid. It is unclear what this provision means. Would this include payments of sales tax reimbursement or use tax to other retailers? Does it mean the amount of sales or use tax paid to the Board as far back as when the taxpayer began filing sales and use tax returns? Does the amount include local and district taxes?
  - **Subdivision (f) of proposed Section 6902.5 is confusing.** This proposed section would limit the allowable refund to the amount of sales and use tax paid, yet the bill states that any refund approved by the Board which may exceed the sales and use tax paid shall be payable from the General Fund. Upon what basis would the Board approve a refund in excess of the sales and use tax paid? If the author intends to enable production companies to receive up to \$3 million per production, perhaps a grant program would be a better approach.
  - **The impact to the Board appears to be minimal, unless we have to verify sales tax reimbursement or use tax paid to other retailers.** Subdivision (h) would require the CFC to provide a list of the taxpayer names, and other related information, to the Board with the total amount of the tax credit allocated to each qualified taxpayer. Other than simply doing the necessary paperwork to generate the refund or apply the credit, it appears the Board would have a minimal role in this credit proposal. However, the term "sales or use taxes

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paid” should be clearly defined in order for the Board to determine the actual impact this bill could have.

- **The Board should be authorized to share information with the CFC.** When the Board makes a refund, or applies a credit to a sales or use tax liability, it appears it would be essential that the CFC be made aware so that it could ensure that the total allowable credits do not exceed the allowable cap (currently unspecified in the bill). However, the bill doesn’t authorize the Board to do so. Section 7056 of the Sales and Use Tax Law prohibits the Board from releasing tax information about taxpayers to outside persons or agencies, unless the Governor authorizes such a release. Either Section 7056 would require an amendment, or a special order from the Governor would be required.
- **Subdivisions (g) and (h) are confusing.** In subdivision (g), the bill specifies that interest shall not apply to any return claiming a credit. However, is it the author’s intent to allow interest on any refunds claimed? What about a return that is filed that has a credit due – would interest apply to that credit amount? In subdivision (h), the bill specifies that the CFC shall provide a list to Board of specified information for each partner or shareholder, as applicable. It is unclear what the Board's interest might be in information about partners and shareholders. In case partners held seller's permits separately from the "qualified motion picture" company, we would not anticipate making refunds to anyone other than the qualified motion picture company.

## **COST ESTIMATE**

It is unclear how many taxpayers would actually be approved by the CFC for the proposed tax credit, since the bill would require CFC to process and approve (or reject) all applications on a first-come first-served basis. This could mean that, depending on the total allowable credit (currently unspecified in the bill), the first applicant could absorb the entire allowable credit, leaving no additional tax credits for any other taxpayers, and the Board would only be processing one refund.

On the other hand, the bill needs more specificity with regard to defining “sales or use taxes paid” and the Board’s role in this credit proposal. If the intent of the bill is to allow a refund up to the amount of sales tax reimbursement or use tax paid by the qualified taxpayers to other retailers, administrative costs would be incurred by the Board to make those verifications. Yet the extent of these costs is unknown due to the uncertainty on how many qualified taxpayers would be allocated tax credits for which the Board would be required to audit.

If the intent of the bill is to simply authorize the Board to issue refunds based on CFC’s allocations, the administrative costs would be minimal. “Minimal” costs is based on the assumption that the CFC would make the notification to qualified taxpayers of the allowable credits and make the necessary verifications that the taxpayers have actually incurred the costs upon which the credit is based. With these uncertainties, it is premature to estimate the administrative costs to the Board.

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**REVENUE ESTIMATE**

The bill would place a cap on the maximum amount of allowable income tax credits, currently unspecified in the bill. Consequently, until the cap is specified, the potential fiscal effect is unknown.

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