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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Chapter 17 of the Third Extraordinary Session**	Bill No:	**SBx3 15**
Tax:	**Sales and Use**	Author:	**Calderon and Florez**
Related Bills:	**AB 15x3 (Krekorian)**		

This analysis is limited to the sales and use tax provisions of this measure.

BILL SUMMARY

Among other things, this bill authorizes an income tax credit equal to the applicable percentage, as specified, of the qualified expenditures attributable to the production of the qualified motion picture in California.

In lieu of claiming that credit, the bill allows qualified taxpayers to claim either a refund of qualified sales and use tax taxes paid under the Sales and Use Tax Law, or a credit against qualified sales and use taxes imposed on the qualified taxpayer, that is equal to the income tax credit amount, or any portion thereof, 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.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

- 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 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, among other things, adds 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 franchise tax an amount equal to:
   - 20 percent of the qualified expenditures attributable to the production of a qualified motion picture in California, or
   - 25 percent of the qualified expenditures attributable to the production of a television series that relocated to California, or an independent film, which is defined as a film with a budget between $1 million and $10 million produced by a non-publicly traded company which is not more than 25 percent owned by a publicly traded company.
2. Define "qualified taxpayer" to mean a taxpayer who has paid or incurred qualified expenditures and has been issued a credit certificate by the California Film Commission (CFC).
3. Define "qualified expenditure" to mean an amount paid or incurred to purchase or lease tangible personal property used within this state in the production of a qualified motion picture and payments, including qualified wages, for services performed within this state in the production of a qualified motion picture.
4. Define "qualified wages" to mean all of the following:
   - Any wages required to be reported under Section 13050 of the Unemployment Insurance Code that were paid or incurred by any taxpayer involved in the production of a qualified motion picture.
   - The portion of any fringe benefits paid or incurred by any taxpayer involved in the production of a qualified motion picture.
   - Any payments made to a qualified entity for services performed in this state by qualified individuals, which is an individual who performs services during the production period in an activity related to the production of a qualified motion picture.

5. Define "qualified motion picture," to mean, among other things a feature with a minimum budget of $1 million and a maximum budget of $75 million. It would exclude from the definition productions such as commercials, music videos, news programs, talk shows, game shows, awards shows, private noncommercial productions (e.g., weddings or graduations).
6. Require the CFC to determine and designate who is a qualified taxpayer and to establish criteria for allocating the credits.
7. Specify that the CFC will allocate not more than $100 million in tax credits each year during the period of 2009-10 through 2013-14 on a first-come-first served basis.
8. Require the CFC to establish a procedure for verifying qualified expenditures. Require the CFC to establish audit requirements that must be satisfied before a credit certificate may be issued by the CFC to a qualified taxpayer.
9. Allow qualified taxpayers, or affiliates that have been assigned any portion of the tax credit amount by the qualified taxpayers, in lieu of claiming the franchise or income tax credit, to either claim a refund of qualified sales and use tax paid, or a credit against qualified sales or use taxes imposed on the qualified taxpayer or imposed on the affiliate that is equal to the credit amount or any portion thereof, that would otherwise be allowed under Section 17053.85 or 23685.
10. "Qualified sales and use taxes" is defined to mean any state sales and use taxes imposed by Part 1 (commencing with Section 6001) of the Sales and Use Tax Law. Provides that "qualified sales and use taxes," does <u>not</u> include taxes imposed by Section 6051.2 and 6201.2 (Local Revenue Fund), 6051.5 and 6201.5 (Fiscal Recovery Fund), Part 1.5 (Bradley-Burns Uniform Local Sales and Use Tax Law), Part 1.6 (Transactions and Use Tax Law), or Section 35 of Article XIII of the California Constitution (Local Public Safety Fund).
11. Requires the Business, Transportation and Housing Agency to report to the Legislature by December 31, 2015, on the economic impact of the credit. The bill would authorize this agency to consult with industry representatives, labor organizations and government agencies, including the Board and the Franchise Tax Board, before completing the report.

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

BACKGROUND

Two similar measures were introduced in the 2007-08 Legislative Session. SB 740 (Calderon and Portantino) would have authorized an income tax credit equal to the applicable percentage, as specified, of the direct tax revenues attributable to the production of a qualified motion picture. SB 359 (Runner) would have authorized income tax credits based on certain wages paid or amounts paid to purchase or lease certain property used to produce motion pictures or commercials in California. Both bills were never heard in committee.

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

COMMENTS

1. **Purpose.** This bill enacts the economic stimulus revenue provisions of the 2009-10 Special Session Budget Agreement. According to a February 20, 2009 press release from the Governor's Office, the economic stimulus package is designed to create jobs and boost California's economy. It includes incentives and gives a competitive edge to companies that are creating jobs for Californians and encourages companies to expand in, and relocate to, California. These incentives in this measure are designed to lure television and movie production back to California.

2. **This analysis focuses primarily on the provisions contained in proposed Section 6902.5 which would fall under the Board's purview.** Some concerns are noted below:

   - **Definition of "qualified sales and use taxes."** The bill defines qualified sales and use taxes to mean state General Fund sales and use taxes *only*. The bill specifies that "qualified sales and use taxes" *does not* include those taxes imposed under:

     - Sections 6051.2 and 6201.2 impose a 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment.
     - Sections 6051.5 and 6201.5 impose a 0.25 percent state tax allocated to the Fiscal Recovery Fund which is dedicated to the repayment of Economic Recovery Bonds.
     - Section 35 of Article XIII of the California Constitution imposes a 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments for program realignment.
     - Part 1.5 (commencing with Section 7200) imposes a 1 percent local tax which is allocated to cities and counties pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law.
     - Part 1.6 (commencing with Section 7251) imposes varying rates ranging from 0.10 to 1 percent which are allocated to local agencies pursuant to the Transactions and Use Tax Law.

     Thus, a qualified taxpayer would be allowed to claim a refund or credit against state General Fund sales and use taxes only. Would a credit or refund include payments made for interest or penalty charges related to the qualified sales and use taxes?

     In addition, paragraph (5)(A) of subdivision (a) provides that *qualified sales and use taxes* means any state sales and use taxes imposed by Part 1 on the *operative date of the act adding this section*. AB 3 of the Third Extraordinary Session (Chapter 18, signed by the Governor on February 20, 2009) increases, temporarily, the rate of the General Fund portion of the state sales and use tax by 1 percent. The increase is effective starting April 1, 2009. Would *qualified sales and use taxes* include the additional 1 percent state sales and use tax rate increase?

- **The bill should clarify what is meant by qualified sales or use taxes *imposed*.** The bill would allow a qualified taxpayer to claim a refund or credit for qualified sales or use taxes imposed on the qualified taxpayer (or an affiliate) and requires the qualified taxpayer or affiliate to submit to the Board the amount of qualified sales and use taxes the claimant remitted to the Board. Since use tax is imposed on purchasers (as for example on certain leases of property, and property purchased from out-of-state retailers), would the refund or credit be applicable to use tax paid by a qualified taxpayer or an affiliate to other retailers, or just the amount actually remitted to the Board? In addition, would a refund or credit be allowed for sales tax reimbursement paid by qualified taxpayers to California retailers? This should be clarified in the bill, in order to determine the impact this measure would have on the Board's workload.

- **It is not clear whether a qualified taxpayer who does not pay income tax or pays only the corporate minimum franchise tax may receive a refund of sales tax reimbursement or use tax.** Existing section 6902.2 provides a similar refund of sales tax reimbursement or use tax that taxpayers may claim "in lieu of" claiming the manufacturers' investment credit on franchise or income tax returns. For taxpayers who actually paid only the corporate minimum franchise tax because they satisfied their franchise tax liability by claiming other credits, such as research and development credits, a controversy arose as to whether such a taxpayer may claim a refund of sales tax reimbursement or use tax "in lieu of" claiming the franchise tax credit. The bill should clarify whether the Legislature intends for qualified taxpayers who actually pay no income tax or the corporate minimum franchise tax to be able to receive refunds of sales tax reimbursement or use tax.

- **It is not clear whether the credits attributable to an independent film, and subsequently sold to an unrelated party, would be allowed to offset any qualified sales and use taxes.** Subdivision (c) of Sections 17053.85 and 23685 allow a qualified taxpayer to sell the credit to an unrelated party if the credit is attributable to an independent film, as defined. However, these same provisions contained in Sections 17053.85 and 23685 are not contained in Section 6902.5 of the Sales and Use Tax Law. It is not clear whether a credit issued for an independent film, and sold to an unrelated party, may be used against sales and use taxes.

- **Period for obtaining a refund or applying a credit needs clarification.** The bill provides that a qualified taxpayer may claim a refund for qualified sales and use taxes paid during the period described in subdivision (c)(1)(D). Subdivision (c)(1)(D) requires the qualified taxpayer to submit to the Board the amount of qualified sales and use taxes that the taxpayer had remitted to the Board during the period commencing on the first day of the calendar quarter immediately before the beginning of the production period, *and ending on the date the taxpayer was required to file its most recent sales and use tax return with the Board*. It is unclear what period would be the most recent period for which the taxpayer would be required to have filed a return.

- **Should the Board provide the FTB with information on the amount of the refund or credit issued to the qualified taxpayer or affiliate?** Subdivision (g) requires the Board to provide to the FTB an annual listing of the qualified taxpayers or affiliates who, during the year, make an irrevocable election to claim a refund or credit in lieu of income taxes. The Board is to provide FTB with the *credit amount claimed* by each qualified taxpayer or the a *portion of the credit amount claimed* by each affiliate. Would it be useful for the FTB to receive information regarding the actual amount refunded for any qualified sales and use taxes paid by the qualified taxpayer or affiliate, and the actual amounts credited against any qualified sales and use taxes imposed on the qualified taxpayer or affiliate?

3. **Related legislation.** This bill is identical to ABx3 15 (Chapter 10 of the Third Extraordinary Session, Krekorian), which was also signed by the Governor Schwarzenegger on February 20, 2009.

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, the first few applicants could absorb the entire allowable credit, leaving no additional tax credits for any other taxpayers, and the Board would only be processing a few credits.

On the other hand, the bill needs more specificity with regard to defining qualified sales and use taxes *imposed* and the Board's role in this proposal. If the intent of the bill is to allow a refund or credit up to the amount of use tax paid by the qualified taxpayers to other retailers (as well as the sales and use tax remitted to the Board, as specified), administrative costs would be incurred by the Board to make those verifications. However, 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. With these uncertainties, it is difficult to clearly identify the administrative costs to the Board.

REVENUE ESTIMATE

The bill would place a cap on the maximum amount of allowable income tax credits of $100 million annually, beginning with the 2009-10 fiscal year and each fiscal year thereafter, through and including 2013-14.

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