INCENTIVES BY STATES TO ENCOURAGE INTRASTATE DEVELOPMENT OF ENTERTAINMENT PROJECTS

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Motion Picture and TV Film production play an important role in California commerce and many other states throughout the U.S. Development of the film infrastructure and supporting industries aids in job creation as well as in the promotion and use of new technologies in motion picture production and TV filming in many different states. Knowing how to properly report taxable income in every state is especially important today in the constantly changing environment of the movie production industry.

I. MOTION PICTURE & TELEVISION PRODUCTION APPORTIONMENT FACTORS

Motion picture and television film producers, producers of television commercials, and television networks that have income from sources within and outside California follow the general rules for apportioning income. The ***property factor*** consists of the net annual rental rate of rented studios, including the basic or flat rental charge for the use of a stage. Rent for other permanent equipment, such as sound recording, rented from other sources or from the studio not covered in the basic charge that are used at least once week are also included.[2]

Films are valued on the basis of their original production costs as determined for federal income tax purposes, before adjustment for federal credits that have not been claimed for state purposes, which includes talent salaries. *The value of the film is not included in the factor until its release date*. Films that are not expensed for California tax purposes at the time of production are included in the denominator of the factor at original cost for 12 years beginning with the release date. Films of a topical nature, including sporting events or interview shows, that are expenses for California tax purposes at the time of production are included at original cost for 1 year beginning with the release date. The value of films is attributed to California in the same ratio as *total California receipts* from such films bears to the *total of such receipts everywhere*.[3]

The numerator of the ***sales factor*** includes the gross receipts from film releases to theaters, TV stations located in the California, the gross receipts from film releases to or by TV network for the network telecast that is attributed to California in the ratio that the audience for the network station located in the California bears to network stations total audience everywhere, the gross receipts from film releases to subscription TV telecasters that is attributed to California in the ratio that the telecaster's California subscribers to the

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[2] Cal. Code Regs. 18 §§25137-8(a) and (c)

[3] Cal. Code Regs. 18 §§25137-8(c)(1)(A), (B), and (C)

telecaster's total subscription everywhere.[4] The denominator of the ***sales factor*** includes the total gross receipts collected from all sources everywhere.

It is important to know what is included in taxable sales and purchases in the motion picture production industry. The terms "sale" and "purchase" include the sale or purchase of raw film or videotape stock, any sale or purchase of release prints or tapes for exhibition or broadcast, any rentals or leases of videocassettes, videotapes, videodisks for private use under which the lessee does not obtain the right to license, broadcast, exhibit, or reproduce the cassette, tape, or disc. The terms "sale" and "purchase" do not include the lease of motion pictures or animated motion pictures, including television, films, and tapes.[5]

The ***payroll factor*** includes talent salaries, residual and profit participation payments, and substantial payments to a corporation for providing the services of an actor or director under contract with such corporation. Compensation of employees in the production of film on location is attributed to the state where the services are performed.[6]

Therefore, motion picture and TV production companies apportion their income using three-factor apportionment formula which consists of property, sales, and payroll attributed to activity within each particular state as compared to total activity in all states.

II. CALIFORNIA INCENTIVES TO PROMOTE ENTERTAINMENT DEVELOPMENT

California has always been one of the leading states involved in the production, development and distribution of motion pictures, sound recordings, and video production of many different films, shows, and digital entertainment products. To encourage continual promotion and development of entertainment, the California has implemented various tax incentives.

One of the taxes imposed by the state of California on production companies is a sales tax. California has extensive ***exemptions*** from sales tax for the ***motion/video and recording industries***, including teleproduction or other postproduction services. Specifically, the sales tax does not apply to charges for the following ***services performed in connection*** with the production, exploitation, or distribution of motion pictures:

- Services that are not fabrication or processing of tangible personal property, including writing, acting, directing, casting, music composing, management, production consulting and services rendered by stage personnel not performing fabrication or processing labor such as grips, property personnel, lighting technicians or transportation drivers. But the

[4] Cal. Code Regs. 18 §25137-8(c)(3)
[5] Cal. Rev. & Tax. §§6010.6(c), Cal. Rev. & Tax. §6006(g)
[6] Cal. Code Regs. 18 §25137-8(c)(2)

persons rendering these services are consumers of any tangible personal property that may be used in rendering the services.

- Repairing, reconditioning, or restoring a qualified motion picture, including the retiming, remounting, or laboratory splicing of negative or positive film, tape, or other audiovisual embodiment.
- Appliance make-up. A person who fabricates and applies expendable appliance make-up is a consumer of materials used.
- Preparation of storyboards for either animation or live photography.
- Creative art services resulting in the transfer, enhancement or revision of any medium including roughs, visualizations, drawings, sketches, renderings, illustrations, layouts, comprehensives, photographs, negatives, transparencies, prints, copies, chromatics, stats, logo types, scans, laser graphics, visual prototypes and electric imagery. The provider of the creative art services is the consumer of the items used in performing such services and tax applies to the sale of items to him or to her. In addition, the recipient of the service would be taxable if he or she later displays the property as a work of art or if the property is physically incorporated into finished art for reproduction by photomechanical processes.[7]

The sales tax ***does not apply*** to charges by a ***recording studio*** for the making of an original recording on recorded media if the recording media is not delivered to the customer, or any person at the direction of the customer, and title is retained by the studio. If the recording studio agrees to furnish records, acetates or other recording media, the tax applies to the sale of such tangible personal property, but the measure of tax is limited to the sale price of the unprocessed recording media, i.e. wax, tape, or other material used to embody the sound. If the studio rents tangible personal property to the customer, the tax applies as it does to rentals in general.[8]

Therefore, California encourages production and development by not charging sales tax to production supporting industries so that motion and TV production will continue to flourish within the State.

III. LOUISIANA INCENTIVES FOR INTRASTATE PROJECT DEVELOPMENT

In order to encourage motion picture and TV film production, employment, and sound recording in the state of Louisiana, state authorities have implemented various tax incentives that are directed towards long-term investment in production facilities within the borders of Louisiana. Some of these tax incentives are listed below to clarify the details of the modern tax law.

Louisiana taxpayers other than ***motion picture production companies*** are allowed a ***credit*** which they earn at the time that a motion picture production company in which

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[7] Cal. Code Regs. 18 §1529(b)(2)(D)
[8] Cal. Code Regs. 18 §1527(a)

they invest makes expenditures in a state-certified production. However, credits cannot be applied against a tax or transferred until the expenditures are *certified* by the Office of Entertainment Industries Development and the Secretary of the Department of Economic Development, and the Division of Administration for infrastructure tax credits. Applicants for the ***motion picture investor credit*** must submit an application form for initial certification to the Office of Entertainment Industries Development. The application form must include the required information, together with an application fee ranging from 0.2% times the estimated total incentive tax credits. The minimum application fee is $200 and the maximum application fee is $5,000. The initial certification is effective for a period of 12 months prior to and 12 months after the date of initial certification, unless production has already started, in which case, the initial certification is valid until the production is completed. *The tax credit is calculated as a percentage of the total base investment dollars certified per project*.[9]

In Louisiana, for state-certified productions approved on or after January 1, 2006, but before July 1, 2010, and for state-certified infrastructure projects approved on or after July 1, 2005, but before July 1, 2012:

- If total base investment is greater than $300,000, each investor is allowed a tax credit of 25% of the base investment made by that investor (20% for state-certified productions approved on or after July 1, 2010, but before July 1, 2012, and 15% for state-certified productions approved on or after July 1, 2012).
- To the extent that base investment is extended on payroll for Louisiana residents employed in connection with a state-certified production, each investor is allowed an additional tax credit of 10% of such payroll. However, if the payroll to any one person exceeds $1 Million, this additional credit excludes any salary for that person that exceeds $1 Million.[10]

It is important to notice that motion picture investor tax credits associated with a state-certified production *cannot* exceed the total base investment in that production. Additionally, the taxpayer cannot duplicate the same assets for the purpose of generation of tax credits.

For state-certified productions that have received an effective certification date prior to December 31, 2005, ***motion picture production companies*** are allowed a ***tax credit for the employment of Louisiana residents*** in connection with the production of a state-certified production. The credit is an amount equal to 10% of the total payroll for Louisiana residents employed in connection with the production, if total production costs in Louisiana equal or exceed $300,000 but total less than $1 Million during the tax year. The credit is 20% of the total payroll for Louisiana residents employed in connection with the production, if the total production costs in Louisiana equal or exceed $1 Million

[9] La. Admin. Code §61:I.1604(B)(6); La. Rev. Stat. Ann. §47:6007(C)(1);Louisiana Rev. Bulletin 06-004, 01/03/06; L. 2006, Act 346

[10] La. Admin. Code §61:I.1601(D); La. Admin. Code §61:I.1607; La. Rev. Stat. Ann. §47:6007(C)

during the tax year. The total payroll figure does not include the salary of an employee whose salary is equal or greater than $1 Million.[11]

A "*state-certified production*" means a production approved by Louisiana's Governor's Office of Film and Television Development and the Department of Economic Development and produced by a motion picture production company domiciled and headquartered in Louisiana which has a marketable commercial distribution plan.

Motion picture production companies employing Louisiana residents must issue either a federal form 1099 or a W-2 to the individual who received the compensation to document the compensation paid. Only salary, wages, or other compensation amounts, including related benefits, paid to an individual for services performed by that individual in connection with a motion picture production are eligible for the credit that movie companies can claim.[12]

Employment tax credits not previously claimed by any taxpayer against its income tax liability and that are held by the motion picture company or that have been allocated to another person may be transferred by the motion picture production company or the person allocated such credits using the same conditions and procedures provided for motion picture investor tax credits.

The motion picture investor credit can be transferred to other Louisiana taxpayers and can be applied against the Louisiana Corporation and personal income taxes, but it cannot be applied against the state corporation franchise tax. The motion picture employment credit is not transferable, but it can be applied against Louisiana Corporation and personal income taxes, and the state corporation franchise tax.[13]

Effective for tax years beginning on or after January 1, 2006, until January 1, 2010, a ***refundable tax credit*** is available for qualified investments in state-certified ***sound recording productions*** or state-certified ***musical recording infrastructure*** projects approved by the Department of Economic Development. Qualified investors earn the credit when their expenditures are *certified* by the Department of Economic Development according to the total base investment certified for the sound recording production company per calendar year. For state-certified productions and state-certified musical recording infrastructure projects certified prior to July 1, 2007, the credit amount allowed for an investor is 10% of the amount of the base investment made by that investor if the total base investment certified for the production company for the calendar year is greater than $15,000 but does not exceed $150,000; 15%, if the total base investment is greater than $150,000 but does not exceed $1 Million; or 20%, if the total base investment is greater than $1 Million. The credit for state-certified productions and state-certified musical recording infrastructure projects certified on and after July 1, 2007, is 25% of the base investment in excess of $15,000. Sound recording investor tax credits associated

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[11] La. Rev. Stat. Ann. §47:1125.1(A)

[12] Louisiana Rev. Bulletin 05-005, 02/16/2005

[13] Louisiana Rev. Bulletin 04-022, 09/22/2004

with a state-certified production *cannot* exceed the total base investment in that production or musical recording infrastructure project. If the total amount of credits applied for in a particular year exceeds the total amount of tax credits allowed for that year, the excess is treated as having been applied for on the first day of the following year. This credit is not allowed for expenditures for which the Louisiana motion picture investor tax credit available and a sound recording production company cannot earn the credit in more than three years out of a 5-year period.[14]

All these tax initiatives made available by Louisiana are directed toward long-term investment into the state of Louisiana so that production can be continued over a long period of time; thus, creating infrastructure for development of employment within the States borders.

IV. NEW YORK STATE INCENTIVES FOR ENTERTAINMENT DEVELOPMENT

New York also created various tax incentives to promote continual investment into the States production infrastructure to promote development of various entertainment projects within its borders.

For tax years beginning in or after 2004, and before 2014, for qualified film production companies or partners of a partnership (including members of limited liability companies treated as partnerships for federal income tax purposes) of qualified film production companies, the State provides an ***Empire State Film Production Credit*** equal to 30% (10% prior to 2008) of the qualified production costs paid or incurred in the production of a qualified film. If the taxpayer satisfies certain criteria regarding a threshold level of activity in New York State, the credit equals 30% of qualified production costs paid or incurred in the production of certain qualified films and television shows. The credit is available for the tax year in which production of the film is completed and cannot reduce the tax due to less than the fixed dollar minimum tax.[15]

The amount of the credit not applied to the tax in the current tax year may be refunded or credited as an overpayment to the next year’s tax. It is important to note that for tax years beginning before January 1, 2008, the refund was limited to 50% of the excess credit in the current year and the balance was carried forward to the following tax year to be deducted from the tax in that year.

The aggregate amount of tax credits allowed in any calendar year is subject to an annual cap. In 2004 and 2005, the annual cap was $25 Million. The cap was increased to $60 Million in 2006 and 2007, $65 Million in 2008, $75 Million in 2009, and $85 Million in 2010. The ***Empire State Film Production Credit*** Program is administered by the

[14] La. Admin. Code §61:I.1635; La. Rev. Stat. Ann. §47:6023; La. Admin. Code §61:I.1637
[15] N.Y. Tax Law §24(a); N.Y. Tax Law §24(b); N.Y. Tax Law §210(36)

Department of Economic Development, Governor's Office for Motion Picture and Television Development.[16]

Production costs for ***Empire State Film Production Credit*** include any costs for tangible property used and services performed directly and predominantly in the production of qualified film. Note that production costs do not include 1) costs for a story, script or scenario to be used for a qualified film, and 2) wages or salaries or other compensation for writers, directors, including music directors, producers and performers. Production costs generally include technical and crew production costs, such as expenditures for film production facilities, or any part thereof, props, makeup, wardrobe, film processing, camera, sound recording, set construction, lighting, shooting, editing, and meals.[17]

For tax years beginning in or after 2007 but before 2012, the state of New York provides a ***Commercial Tax Credit*** against the franchise tax for a taxpayer that is a Q***ualified Commercial Production company***. At least 75% of the production costs paid or incurred directly and predominantly in the actual filming or recording of the qualified commercial must be incurred in the New York State. The state is allowed to issue permits for an aggregate amount of $7 Million in commercial production credits per year.[18]

It is important to clarify the definition under the tax law of a qualified commercial in the state of New York. A ***qualified commercial*** is an advertisement that is recorded on film, audiotape, videotape or digital medium in New York for multi-market segment distribution by way of radio, television networks, cable, satellite or motion picture theaters. A qualified commercial does not include: 1) a news or current affairs program, an interview or talk program, network promos, i.e. commercials promoting television series or movies, a "how-to" commercial or program, a commercial or program consisting entirely of stock footage, trailers promoting theatrical films, a sporting event or sporting program, a game show, an award ceremony, a daytime drama, or 2) a production for which records are required under the Code with respect to any performer in such production.[19]

In each specific case, qualified production costs used by a taxpayer either as the basis for the allowance of this credit or in the calculation of the credit cannot be used by the taxpayer to claim any other franchise tax credit.

V. CONCLUSION

Prior to starting any major project, motion picture or TV Film, a production company must determine the level of expenditures and benefits available in any given

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[16] N.Y. Tax Law §24; N.Y. Tax Law §210(36)
[17] N.Y. Tax Law §24(b)(2)
[18] N.Y. Tax Law §28(a); N.Y. Tax Law §210(38); New York Technical Service Bureau Memorandum TSB-M-07(3)C, 01/30/2007
[19] N.Y. Tax Law §28(b)(3)

state. Some states provide greater benefits than others so that investment dollars will flow into it as opposed as to other states. A thorough analysis of the base investment expenditures and tax benefits provided by each state is the key to successful long-term tax planning strategy by any entity thinking of moving its operations from one state into another.