LEGISLATIVE FISCAL ESTIMATE

[First Reprint]

ASSEMBLY, No. 1038

STATE OF NEW JERSEY
218th LEGISLATURE

DATED: APRIL 19, 2018

SUMMARY

Synopsis: Provides corporation business tax and gross income tax credit for certain expenses incurred for production of certain films and digital media content; designated as Garden State Film and Digital Media Jobs Act.

Type of Impact: Potential negative fiscal net impact on State General Fund and Property Tax Relief Fund; potential revenue increase to affected local governments.

Agencies Affected: Department of the Treasury;
Economic Development Authority;
Motion Picture and Television Development Commission;
Local Governments.

Office of Legislative Services Estimate

Fiscal Impact	Multi-Year Lifespan of Tax Credit Awards
Direct <u>State</u> Revenue <u>Loss</u>	Up to $425,000,000
Indirect <u>State</u> Revenue <u>Gain</u>	Indeterminate
<u>State</u> Opportunity Cost	Indeterminate
Indirect <u>Local</u> Revenue Gain	Indeterminate

- The Office of Legislative Services (OLS) expects the bill to produce a negative fiscal net impact of indeterminate magnitude on the State, considering that the bill does not require tax credit-receiving expenses to yield a net fiscal benefit to the State. The OLS' inability to quantify the fiscal net impact is rooted in imperfect information regarding: a) the number and attributes of newly eligible film and digital media projects and expenses; and b) the State spending that may be crowded out by new incentive awards.

- The bill's direct revenue loss to the State General Fund and Property Tax Relief Fund could total up to $425 million over the multi-year lifespan of qualified film production and qualified digital media content production tax credit awards. These tax credit awards are capped annually at $75 million and $10 million, respectively, and are restricted to a five-year period from FY 2019 through FY 2023.

BILL DESCRIPTION

The bill establishes a five-year tax credit program for certain film and digital media production expenses incurred in this State. For each fiscal year from FY 2019 through FY 2023 no more than $75 million in tax credits may be granted for qualified film production expenses and no more than $10 million in tax credits for qualified digital media content production expenses. The credits are available under the corporation business tax and the gross income tax.

Tax credit amounts equal 30 percent of a taxpayer's qualified film production expenses or 20 percent of a taxpayer's qualified digital media content production expenses. The allowable credit equals 35 percent of the qualified film production expenses or 25 percent of the qualified digital media content production expenses if the qualified expenses are incurred for services performed and tangible personal property used or consumed in Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, or Salem County.

In order to claim the tax credit for qualified film production expenses, several conditions must be met, including: the film includes, when determined to be appropriate by the Motion Picture and Television Development Commission, at no cost to the State, marketing materials promoting this State as a film and entertainment production destination; and at least 60 percent of the total film production expenses, exclusive of post-production costs, of the taxpayer are incurred for services performed and goods purchased through vendors authorized to do business in New Jersey, or the qualified production expenses of the taxpayer during a tax year exceed $1 million per production.

In order to claim the tax credit for qualified digital media content production expenses, several conditions must be met, including: at least $2 million of the total digital media content production expenses of the taxpayer are incurred for services performed and goods purchased through vendors authorized to do business in this State; and at least 50 percent of the qualified digital media content production expenses of the taxpayer are for wages and salaries paid to full-time or full-time equivalent employees in this State.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS expects the bill to produce a negative fiscal net impact of indeterminate magnitude on the State, and a potential revenue gain to affected local governments. Conceptually, the fiscal net impact to the State is calculated by adding the direct revenue loss from awarding additional incentive amounts and their opportunity costs (the fiscal benefits the State forgoes as spending is redirected from one economic activity to another) and subtracting from that sum the indirect revenue gain that will accrue from additional economic activity that the additional incentive amounts will catalyze.

Direct State Revenue Loss: The bill's direct revenue loss to the State General Fund and Property Tax Relief Fund could total up to $425 million over the multi-year lifespan of qualified film production and qualified digital media content production tax credit awards.

The bill provides two tax credits: a qualified film production tax credit and a qualified digital media content production tax credit. Tax credit awards are capped annually at $75 million and $10 million, respectively, and are restricted to a five-year period from FY 2019 through FY 2023. The qualified film production tax credit is equal to 30 percent of a taxpayer's qualified expenses during a tax year, and the qualified digital media content production tax credit is equal to 20 percent of a taxpayer's qualified expenses. The bill provides enhanced incentives for qualified film production expenses (35 percent of expenses) and qualified digital media content production expenses (25 percent of expenses) incurred for services performed and tangible personal property purchased through vendors whose primary place of business is located in Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, or Salem County.

Given that tax credits can only be awarded from July 1, 2018 to June 30, 2023, the OLS notes there would be no additional tax credit awards in FY 2024 and thereafter.

This timeline represents a simplification, though, as the OLS assumes that taxpayers will apply the tax credits against their tax liabilities in the year in which the New Jersey Economic Development Authority (EDA) grants them. In actuality, the use of approved tax credit amounts can be expected to extend over several fiscal years, for not all taxpayers will have a sufficient tax liability against which to apply the tax credits upon receipt and the bill allows taxpayers to carry unused tax credit amounts forward for up to seven tax years.

Indirect State and Local Revenue Gain: The OLS cannot quantify the bill's indirect revenue gain to the State and local governments from the issuance of qualified film production tax credits and qualified digital media content production tax credits because of imperfect information on the number and attributes of newly eligible film and digital media projects and expenses. But, for reasons explained below, the OLS anticipates the bill's indirect State and local government revenue gain to fall below its direct State revenue loss of up to $425 million.

Analytical Framework: Like any government expenditure, incentive awards inject new spending into the economy. Once businesses and individuals receive payments they would not receive absent the incentive awards, at least a portion of these payments will newly circulate in New Jersey's economy and produce so-called "multiplier effects." As the additional financial resources flow through the economy they generate, as a byproduct, additional State and local revenue collections—the indirect revenue gain discussed in this section. Examples are enhanced local property tax collections accruing when an incentive recipient invests the incentive amount in facility improvements, which then appreciate the property's value; or additional State sales and use tax collections from construction workers employed in the facility improvement spending their resultant income on taxable goods and services.

Indirect State fiscal effects offset the State's direct cost of awarding incentives in part or potentially even in whole. Fiscal "multiplier effects" tend to be maximized whenever an incentive award serves as the indispensable impetus for additional spending by the incentive recipient that would not otherwise occur. In this case, the incentive recipient magnifies the positive economic and fiscal impacts of the State's outlay. Depending on project and incentive attributes, the induced project may even yield indirect fiscal State benefits exceeding the cost of the subsidy. The larger the proportion of the public assistance relative to the financial outlay by the subsidized party, however, the lower the probability that the subsidized activity will generate positive net returns to the State.

In contrast, the State's return on investment is negative whenever the State subsidizes a project that a taxpayer would have undertaken with or without public assistance. Because the financial inducement has not caused the project's realization, none of its economic and fiscal feedback effects are attributable to the incentive, and therefore must be excluded from the tabulation of the incentive's indirect fiscal benefits.

Nevertheless, even if the State provides financial assistance to a project that would be realized anyway, some, albeit comparatively small, indirect fiscal benefits may still accrue to the State. These would occur whenever the subsidy beneficiary spends the incentive award in New Jersey on goods and services that the beneficiary would otherwise not have procured. In that event the incentive award still represents an injection of additional cash into New Jersey's economy whose ripple effects include the accumulation of indirect fiscal State benefits.

Lastly, given the high degree of integration of New Jersey's economy with the national and global economies, an addition of spending in New Jersey will eventually leak into other jurisdictions and cease to circulate within the State. Consequently, any tabulation of a subsidy payment's New Jersey feedback effects must disregard feedback effects that other jurisdictions will absorb.

<u>Bill's State Indirect Fiscal Effects:</u> One aspect of the tax credits provided in the bill motivates the OLS to expect that the bill's direct State revenue loss will exceed its indirect State and local government revenue gain. The bill does not subject credit-receiving expenses to a multiplier-based net benefit test calculation, which for other economic development incentive programs is intended to ensure that the EDA will award tax incentives only to projects that are estimated to generate indirect State revenue in excess of a tax incentive's direct State cost. Without the net benefit test requirement, projects will also be eligible for tax credits that taxpayers would have undertaken with or without the State subsidy.

Irrespective of the magnitude of the bill's indirect fiscal benefits, the analysis of its full impact on State finances is incomplete without considering the bill's opportunity costs.

<u>State Opportunity Costs:</u> Given the State's finite resources and its balanced budget requirement, the decision to award film production and digital media content production tax credits under the bill will invariably divert resources from policy alternatives to which they would have been applied absent the inducements. These policy alternatives also produce direct State costs and indirect State revenue collections. The concept of opportunity costs captures the value of these fiscal benefits the State forgoes as it redirects cash flows. Once opportunity costs are factored into the analysis, it is therefore possible for a bill to produce a *net* fiscal loss to the State even if its indirect fiscal benefits exceed its direct cost.

For example, if, instead of this bill, the State invested in road construction, the bill would produce a *net* fiscal effect equal to the difference between the total fiscal impact of the tax credit awards—or the direct State cost of awarding film production and digital media content production tax credits, minus the incentives' indirect State fiscal effects—and that of the forgone road construction investment.

Section: *Revenue, Finance and Appropriations*

Analyst: *Jordan M. DiGiovanni*
Associate Fiscal Analyst

Approved: *Frank W. Haines III*
Legislative Budget and Finance Officer

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).