DEPARTMENT OF TAXATION
2020 Fiscal Impact Statement

1. Patron Glenn R. Davis

2. Bill Number HB 139

House of Origin:

_____ **Introduced**

__X__ **Substitute**

_____ **Engrossed**

Second House:

_____ **In Committee**

_____ **Substitute**

_____ **Enrolled**

3. Committee House Appropriations Committee

4. Title Individual Income Tax and Corporate Income Tax; New Media and Technology Innovation Income Tax Credit

5. Summary/Purpose:

This bill would establish an individual and corporate income tax credit for certain expenses related to the production of an episodic television series, commercial advertisement, or digital interactive media production. The credit would be comprised of three separate components:

- A credit equal to 15 percent of a company's qualifying expenses related to an eligible project, or 20 percent of such expenses if the eligible project is produced in an economically distressed area of the Commonwealth.
- An additional credit equal to 10 percent of the total aggregate payroll of Virginia residents employed in connection with the production of an eligible project in the Commonwealth when total production costs in the Commonwealth are at least $250,000 but not more than $1 million, or 20 percent of such payroll expenses if total production costs in the Commonwealth exceed $1 million.
- An additional credit in an amount equal to 10 percent of the total aggregate payroll for Virginia residents employed for the first time as actors or members of a production crew in connection with the production of an eligible project in the Commonwealth.

This bill would permit the taxpayer holding this credit to transfer unused credits to another taxpayer for use on their Virginia income tax return. This bill would also authorize the Governor to buy back unused credit using funds appropriate by the General Assembly for such purpose.

This credit would not be subject to an annual credit cap.

The Department and Virginia Film Office would be prohibited from authorizing the issuance of credits that would have an impact on General Fund revenue prior to Fiscal Year 2022.

The provisions of this bill that would establish the credit would be effective for taxable years beginning on or after January 1, 2022. If this bill is enacted during the 2020 Regular Session of the General Assembly, the other provisions of this bill would become effective July 1, 2020.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Not available. (See Line 8.)

7a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2022-23	($72.750)	1	GF
2023-24	($70,050)	1	GF
2024-25	($70,050)	1	GF
2025-26	($70,050)	1	GF

8. Fiscal implications:

<u>Administrative Costs</u>

Virginia Film Office

The Virginia Film Office ("VFO") considers implementation of this bill as routine, and does not require additional funding.

MEI Project Approval Commission

The MEI Project Approval Commission estimates that it would need to hold one or two additional meetings per year as a result of this bill. Therefore, at a minimum, it would incur estimated costs of $1,010 per meeting to cover per diem and mileage reimbursements for Senators and Delegates who are members of such commission.

Department of Taxation

The Department of Taxation ("the Department") estimates it would incur administrative costs of $72,750 in Fiscal Year 2023 and $70,050 in Fiscal Year 2024 and all subsequent years. These costs would be incurred for purposes of hiring one full time employee to administer the Department's responsibilities with respect to the credit, and additional ongoing operational expenses related to overseeing this credit program.

<u>Revenue Impact</u>

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2023. It is unknown how many taxpayers would potentially qualify for this credit. Because the aggregate amount of credit that taxpayers may claim per taxable year would be uncapped, this credit would potentially result in a significant negative revenue impact.

9. Specific agency or political subdivisions affected:

Virginia Film Office
MEI Project Approval Commission
Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Motion Picture Production Tax Credit

Virginia provides a series of refundable individual and corporate income credits for motion picture production companies that meet certain criteria. A motion picture production company with qualifying expenses of at least $250,000 may receive a credit equal to 15 percent of qualifying expenses or 20 percent of qualifying expenses if the production is filmed in an economically distressed area of Virginia.

A motion picture production company may receive an additional credit equal to 10 percent of the total aggregate payroll for Virginia residents employed in connection with the production of a film in Virginia when total production costs in Virginia are at least $250,000, but not more than $1 million. This additional credit is equal to 20 percent of the total aggregate payroll of such residents when total production costs in Virginia exceed $1 million.

A motion picture production company may also receive an additional credit equal to 10 percent of the total aggregate payroll for Virginia residents employed for the first time as actors or members of a production crew in connection with the production of a film in Virginia.

"Qualifying expenses" are defined as the sum of the following amounts spent in Virginia by a production company for the production of a motion picture film or an episodic television series filmed in Virginia:

- Goods and services leased or purchased.
- Compensation and wages of up to $1 million per individual for personal services with respect to a single motion picture production.

The aggregate amount of all credits that may be allocated to taxpayers is capped at $6.5 million per fiscal year.

Film Tax Credits in Other States

Thirty-two states and the District of Columbia allow film tax incentives. Eighteen states (Alaska, Arizona, Delaware, Florida, Idaho, Indiana, Iowa, Kansas, Michigan, Missouri, Nebraska, New Hampshire, North Dakota, South Dakota, Vermont, West Virginia, Wisconsin and Wyoming) do not provide film tax incentives.

Sunset Dates for Income Tax Credits and Sales Tax Exemptions

Section 3-5.14 of the Appropriation Act provides that the General Assembly may not advance the sunset date for any existing income tax credit or sales tax exemption beyond June 30, 2022. Any new income tax credit or sales tax exemption enacted by the General Assembly prior to the 2021 Session must have a sunset date not later than June 30, 2022. This requirement does not apply to sales tax exemptions related to nonprofit entities or to income tax credits or sales tax exemptions with sunset dates after June 30, 2022 that were enacted or advanced during the 2016 Session.

Further, during the 2012 Session, the General Assembly enacted House Bill 246, which prohibits legislation from adding a new credit or renewing an existing credit unless the legislation contains a sunset date of not longer than five years from the effective date of the new or renewed credit.

Proposed Legislation

Establishment of the New Media and Technology Innovation Income Tax Credit

This bill would establish an individual and corporate income tax credit for certain expenses related to the production of an episodic television series, commercial advertisement, or digital interactive media production. The credit would be comprised of three separate components:

- A credit equal to 15 percent of a company's qualifying expenses related to an eligible project, or 20 percent of such expenses if the eligible project is produced in an economically distressed area of the Commonwealth, as designated by the Virginia Economic Development Partnership Authority ("VEDP").
- An additional credit equal to 10 percent of the total aggregate payroll of Virginia residents employed in connection with the production of an eligible project in the Commonwealth when total production costs in the Commonwealth are at least $250,000 but not more than $1 million. The additional credit would be in an amount equal to 20 percent of such payroll expenses if total production costs in the Commonwealth exceed $1 million.
- An additional credit in an amount equal to 10 percent of the total aggregate payroll for Virginia residents employed for the first time as actors or members of a production crew in connection with the production of an eligible project in the Commonwealth.

"Commercial advertisement" would be defined as an advertisement recorded on film videotape, or a digital medium for multi-market distribution that extends outside the Commonwealth by way of broadcast television networks, cable, satellite, the internet, DVD, home video, or motion picture theaters.

"Commission" would be defined as the MEI Project Approval Commission.

"Digital interactive media production" would be defined as any interactive entertainment intended for commercial exploitation, including video game projects, console games, computer games, handheld console games, mobile electronic device games, massively multi-player online video games and virtual worlds that meet the requirements of multi-market distribution via the internet or any other channel of exhibition, and games that use augmented reality, virtual reality, or mixed reality.

"Eligible projects" would be defined as the production of an episodic television series, commercial advertisement, or digital interactive media production. "Eligible project" would not include any production that (i) is political advertising, (ii) is a television production of a news program or live sporting event, (iii) contains obscene material, (iv) is a reality television production, or (v) receives or received grants or loans under the Governor's Motion Picture Opportunity Fund or the Motion Picture Production Tax Credit.

"Episodic television series" would be defined as a television program consisting of multiple episodes of a single season. In the case of an episodic television series, an entire season of episodes would be deemed to be one production.

“Qualifying expenses” would be defined as the sum of the following amounts spent in the Commonwealth by a production company in connection with the production of an eligible project produced in the Commonwealth:

- Goods and services leased or purchased. For goods with a purchase price of $25,000 or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.
- Compensation and wages, except in the case of each individual who directly or indirectly receives compensation in excess of $1 million for personal services with respect to a single production. In such a case, only the first $1 million of salary would be considered a qualifying expense. An individual would be deemed to receive compensation indirectly when a production company pays a personal service company or an employee leasing company that pays the individual.

“Qualifying expenses” would not include any expenses that were exempt from the retail sales and use tax. However, if a taxpayer accrued such expenses at least 1 year prior to entering into a memorandum of understanding with the VFO and such expenses were exempt from the retail sales and use tax, such expenses may be counted as qualifying expenses.

The Department and Virginia Film Office would be prohibited from authorizing the issuance of credits that would have an impact on General Fund revenue prior to Fiscal Year 2022.

If the amount of the credit exceeds the taxpayer’s tax liability for the taxable year, the excess would be permitted to be carried over for credit against the income taxes of the taxpayer in the next 10 taxable years, or until the total credit amount has been taken, whichever occurs first.

Any credits that are received by a pass-through entity, such as a trust, estate, partnership, limited liability company or partnership, limited partnership, Subchapter S corporation, or any other fiduciary would be required to be used either by such entity or by the member, manager, partner, shareholder, or beneficiary in proportion to their interest in such entity in the event that income, deductions, and tax liability pass through such entity to such member, manager, partner, shareholder, or beneficiary or as set forth in the agreement of such entity. Credits would not be permitted to be claimed by both the entity and the member, manager, partner, shareholder, or beneficiary for the same expenses.

No taxpayer would be permitted to claim this credit and the Motion Picture Production Tax Credit for the same expenses.

The VFO and the Department would be required to develop guidelines, exempt from the Administrative Process Act, implementing the provisions of this credit program.

Procedure for Applying for Credits and Reviewing Applications

The issuance of tax credits under this bill would be required to be completed in accordance with procedures, qualifying criteria, and deadlines established by the Department and the VFO. The qualifying criteria established by the VFO would be required to take into account whether the eligible project involves physical production within the Commonwealth, the number of residents of Virginia that will be employed in the eligible project and the level of compensation they will be paid, the extent to which the eligible project will impact existing local businesses and the local economy, the extent to which the eligible project will involve existing and new companies located in Virginia, and other relevant considerations. The taxpayer would be required to apply for the credit by submitting an application, as prescribed by the VFO, prior to the start of production in Virginia.

The Commission would be required to review applications for credits to determine whether such applications meet the eligibility criteria specified in guidelines regarding the credit to be promulgated by the VFO. The Commission would be required to recommend approval or denial of an application to the VFO according to whether the application meets such criteria. Additional factors that would be required to be considered by the Commission in its review would include:

- Return on investment;
- The time frame for repayment of incentives to the Commonwealth;
- Average wages of the jobs created by the prospective project;
- The amount of capital investment that is required; and
- The need for enhanced employment opportunities in the prospective location of the prospective project.

Any time a proposed individual incentive package is to be considered by the Commission, the following information would be required to be provided to Commission members not less than 48 hours prior to the scheduled Commission meeting:

- The value of the proposed credits;
- Assumed return on investment;
- The time frame for repayment of incentives to the Commonwealth;
- The average wages of the jobs created by the prospective project;
- The amount of capital investment that is required; and
- The need for enhanced employment opportunities in the prospective location of the prospective project.

The timing of any requires for an endorsement of an application would be scheduled so that the Commission has, at its discretion, up to 7 days subsequent to the presentation of the incentive package for the review of such proposal.

Any affirmative vote by three of the five members of the Commission from the House of Delegates and two of the three members of the Commission from the Senate would be required to endorse any application.

Notwithstanding the statutory provisions protecting the secrecy of certain taxpayer information, the Department and the VFO would be required to share applications for tax credits and related information with the Commission. The Commission would be required to review such information and recommend to the VFO whether such application should be approved. The VFO would be required to consider such recommendation.

Any taxpayer seeking credits would be required to enter into a memorandum of understanding with the VFO that, at a minimum, provides the requirements that the taxpayer would be required meet to receive the credits, including the estimated amount of money to be spent in Virginia, the timeline for completing the eligible project, and the maximum amount of credits allocated to the taxpayer. Once the taxpayer has satisfied all the requirements in the memorandum of understanding to the satisfaction of the VFO and has completed the eligible project, the taxpayer would be eligible to claim the applicable amount of credits up to the amount that has been allocated by the VFO on the tax return filed for that taxable year. The taxpayer's return would be required to contain information disclosing the name of the eligible project, provide a description of the eligible project, and include a detailed accounting of the qualifying expenses with respect to which a credit is claimed.

A taxpayer allowed a credit would be required to maintain and make available for inspection any information or records required by the Tax Commissioner. The taxpayer would have the burden of proving eligibility for a credit and the amount of the credit. The Tax Commissioner would be required to consult with the VFO in order to determine the amount of qualifying expenses and amount of tax credit authorized. For any year for which a taxpayer claims a credit, such taxpayer would be required to have an audit for such year performed by an independent certified public accountant of such taxpayer's qualifying expenses and any other information required by the Department. A summary report of the audit would be made available to the public and the Department upon request by the Department.

Transfer of Credits

This bill would permit any taxpayer holding credits to transfer unused, but otherwise allowable credits, for use by another taxpayer on their Virginia income tax return. A taxpayer that transfers any amount of credits would be required to file a notification of such transfer to the Department in accordance with procedures and forms prescribed by the Tax Commissioner.

A fee of two percent of the value of the qualifying expenses associated with the transferred credits would be imposed upon any transfer arising from the sale by any taxpayer of credits and upon the distribution of a portion of credits to a member, manager, partner, shareholder, or beneficiary. Revenues generated by such fees first would be used by the Department for its costs in implementing this credit, but in no event would such costs exceed 50 percent of the total revenue generated by the fee on an annual basis. The remainder of such revenues would be required to accrue to the Governor's Motion Picture Opportunity Fund.

To the extent included in and not otherwise subtracted from the federal adjusted gross income of an individual income taxpayer or the federal taxable income of a corporate income taxpayer, a taxpayer would be permitted to subtract any amount of gain or income recognized on the application of a credit against a Virginia income tax liability. The transfer of the credit and its application against a tax liability would not create gain or loss for the transferor or the transferee of such credit.

A pass-through tax entity, such as a partnership, limited liability company, or Subchapter S corporation, would be authorized to appoint a tax matters representative, who would be required to be a general partner, member/manager, or shareholder, and register that representative with the Tax Commissioner. The Tax Commissioner would be entitled to deal with the tax matters representative as representative of the taxpayers to whom credits have been allocated or transferred by the entity under this article with respect to those credits. In the event that a pass-through tax entity allocates or transfers tax credits to its partners, members, or shareholders and the allocated or transferred credits are disallowed, in whole or in part, such that an assessment of additional tax against a taxpayer is be made, the Tax Commissioner would first be required to make written demand for payment of any additional tax, together with interest and penalties, from the tax matters representative. In the event that such payment demand is not satisfied, the Tax Commissioner would be required to proceed to collection against the taxpayers

Buyback of Credits

The Governor would be permitted to buy back tax credits issued, provided that the price paid is at least 80 percent of the dollar value of the tax credits, using funds the General Assembly may appropriate for such purpose. The Governor would also be required to submit with his or her Introduced Executive Budget a statement of proposed appropriations to be used to buy back credits.

Annual Reports Regarding the Credit

The Commission would be required to report annually by the first day of each General Assembly Regular Session on all endorsed applications. Such report would be required to include the following information the:

- Impact of the credit on new media and technology innovation in Virginia;
- Known competitor states in new media and technology innovation;
- Employment creation and capital investment expectations;
- Anticipated average annual wage of the new jobs;
- Local and state returns on investment as prepared by VEDP; and
- Expected time frame for repayment of the incentives to the Commonwealth in the form of direct and indirect general tax revenues.

The Department, in consultation with the VFO, would be required to publish by November 1 of each year for the 12-month period ending the preceding December 31 the following information:

- Location of sites used in an eligible project for which a credit was claimed;
- Qualifying expenses for which a credit was claimed, classified by whether the expenses were for goods, services, or compensation paid by the company;
- Number of people employed in the Commonwealth with respect to credits claimed; and
- Total cost to the Commonwealth's general fund of the credits claimed.

Notwithstanding the statutory provisions protecting the secrecy of certain taxpayer information, such information would be required to be published by the Department, even if such information is not classified, so as to prevent the identification of particular taxpayers, reports, or returns and items.

The provisions of this bill that would establish the credit would be effective for taxable years beginning on or after January 1, 2022. If this bill is enacted during the 2020 Regular Session of the General Assembly, the other provisions of this bill would become effective July 1, 2020.

<u>Similar Bills</u>

House Bill 1318 would extend the sunset date for the Motion Picture Production Tax Credit, transfer authority for the credit from the VFO to the Virginia Tourism Authority, and allow amounts of credits that are not issued to taxpayers to be allocated to taxpayers in future taxable years.

House Bill 1533 would increase the annual credit cap for the Motion Picture Production Tax Credit from $6.5 million to $13 million, and require $6.5 million of the total amount to be allocated for motion picture productions in economically distressed areas of the Commonwealth.

Senate Bill 923 would extend the sunset date for the Motion Picture Production Tax Credit from January 1, 2022 to January 1, 2027.

cc : Secretary of Finance

Date: 2/1/2020 RWC
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