



Legislative Fiscal Bureau

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March 30, 2006

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 563: Income and Franchise Tax--Film Production Services and Production Company Investment Tax Credits

Senate Bill 563, which would create film production services and production company investment tax credits, was introduced on February 3, 2006, and referred to the Senate Committee on Job Creation, Economic Development, and Consumer Affairs. On February 14, 2006, Senate Amendment 1 to SB 563 was adopted by vote of 4-0, and the bill, as amended, was recommended for passage by a vote of 4-0.

CURRENT LAW

Under the state individual and corporate income and franchise taxes, costs related to the operation of a business are deductible as business expenses if the expenses are ordinary and necessary and connected to the trade and business of the taxpayer. A deduction is provided for a reasonable salary allowance or other compensation for services actually rendered by employees. The form of compensation payment--fixed salary, percentage of gross or net income, commissions, bonuses, contributions to pensions or profit sharing plans--is not controlling as to deductibility. A deduction is allowed for the following types of taxes generally for the year in which they are incurred or paid: (a) one-half of the federal self-employment tax; (b) state, local, and foreign real property taxes; (c) state and local personal property taxes; (d) state, local, and foreign income, war profits, and excess profits taxes; and (e) the generation-skipping transfer tax imposed on income distributions. In addition, any state, local, and foreign taxes paid or accrued in carrying on a trade or business or in connection with the production of income (such as sales taxes on production inputs) are deductible.

The deduction for depreciation allows taxpayers to recover, over a period of years, the cost of capital assets used in a trade or business or for the production of income. The deduction is an allowance for the wear and tear, deterioration, or obsolescence of the property. To be depreciable, the property must have a determinable life of more than one year, and it must decline in value through use or the passage of time. Only property used in a trade or business or held for the production of income is eligible for a depreciation deduction. The amount to be recovered by depreciation is the cost or other appropriate basis of the property. The life over which the depreciable basis of property is recovered depends upon the type of asset that is depreciated and the system of depreciation that is used.

Tangible depreciable property currently placed in service is generally subject to the Modified Accelerated Cost Recovery System (MACRS). Under MACRS, the cost of property is recovered by using accelerated methods of cost recovery and statutory recovery periods and conventions. The deduction is computed by first determining the MACRS basis of the property. Each item of eligible property is then assigned to a specific class and each class establishes a recovery period over which the cost of the property is recouped using the applicable depreciation method and convention. Depreciation tables may be used by multiplying the basis of the assets by the applicable percentage for the applicable year of the recovery period. Alternatively, the deduction can be calculated using the appropriate method, recovery period, and convention.

Under Section 179 of the Internal Revenue Code (IRC), a taxpayer may elect to treat all or a portion of the cost of qualifying property, up to a limit, as an expense rather than as a capital expenditure. Such an expense or cost is deductible in the year in which the property is placed in service. The amount claimed as a deduction is referred to as a Section 179 expense allowance. Qualifying property is generally:

- a. Tangible personal property.
- b. Other tangible property (except buildings and their structural components) used as:
(1) an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services; (2) a research facility used in connection with any of these activities; or (3) a facility used in connection with such activities for the bulk storage of tangible commodities.
- c. Single purpose agricultural property (livestock or horticultural structures).
- d. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.
- e. Off-the-shelf computer software (this type of property is not eligible for Section 179 treatment under Wisconsin law).

Under current Wisconsin law, a taxpayer may elect to deduct up to \$25,000 of the cost of qualifying property in the year it is placed in service, rather than taking depreciation deductions over a specified recovery period. In general, qualifying property is depreciable tangible personal property that is purchased for the active conduct of a trade or business. The maximum deductible amount of \$25,000 is reduced (but not below zero) by the amount by which the qualifying property placed in service during the taxable year exceeds \$200,000. In addition, the amount eligible to be expended for a taxable year may not exceed the taxable income of the taxpayer that is derived from the active conduct of a trade or a business for that year. Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding years and deducted, subject to the total investment and taxable income limits.

SUMMARY OF BILL

Senate Bill 563 would create both a film production services tax credit and a film production company investment tax credit under the state individual and corporate income and franchise taxes, for tax years beginning after December 31, 2005.

Film Production Services Tax Credit. An eligible taxpayer could claim as a credit against the individual and corporate income and franchise taxes any of the following:

a. An amount equal to 25% of the salary or wages paid by the claimant to the claimant's employees, up to a maximum credit of \$25,000 per employee, for services rendered in the state to produce an accredited production and paid to employees who were residents of the state at the time they were paid. The salary or wages would have to be paid for services rendered after December 31, 2005, and directly incurred to produce the accredited production. The tax credit could not be claimed for the salaries or wages of the two highest paid employees. Unused tax credit amounts could be carried forward up to fifteen years to offset future tax liabilities.

b. An amount equal to 25% of production expenses paid by the claimant to produce an accredited production. If the amount of tax credit exceeded the taxpayer's income or franchise tax liability, the amount of credit not used to offset the tax due would be certified by the Department of Revenue and refunded to the claimant by check, share draft, or other draft. Credit refunds would be paid from a newly-created GPR sum sufficient appropriation.

c. An amount equal to the sales and use taxes paid by the claimant on the purchase of tangible personal property and taxable services that were used directly in producing an accredited production in the state, including all stages of production, from the final script stage to the distribution of the finished production. Unused tax credit amounts could be carried forward up to fifteen years to offset future tax liabilities.

In order to claim a tax credit, the claimant would be required to file an application with the Department of Commerce, at the time and in a manner prescribed by Commerce, and Commerce would be required to approve the application.

Partnerships, limited liability companies (LLCs), and tax-option corporations (S corporations) could not claim the tax credit, but eligibility for and the amount of the credit would be based on the entity's payment of allowable wages and salaries. A partnership, LLC, or tax-option corporation would be required to compute the amount of the tax credit each of its partners, members or shareholders could claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations would claim the credit in proportion to their ownership interest.

"Accredited production" would be defined as a film, video, electronic game, broadcast advertisement, or television production, as approved by the Department of Commerce, for which aggregate salary and wages included in the cost of production for the period ending 12 months after the month in which the principal filming or taping of the production begins exceeds \$100,000 for a production that is 30 minutes or longer, or \$50,000 for a production that is less than 30 minutes. "Accredited production" would not include any of the following, regardless of production costs:

- a. News, current events, or public programming, or a program that includes weather or market reports.
- b. A talk show.
- c. A production with respect to a questionnaire or contest.
- d. A sports event or sports activity.
- e. A gala presentation or awards show.
- f. A finished production that solicits funds.
- g. A production for which the production company is required under federal law to maintain records with respect to performers in programs with sexually explicit content.
- h. A production produced primarily for industrial, corporate, or institutional purposes.

"Production expenditures" would mean any expenditures that were incurred in the state and directly used to produce an accredited production, including expenditures for set construction and operation, wardrobes, make-up, clothing accessories, photography, sound recording, sound synchronization, sound mixing, lighting, editing, film processing, film transferring, special effects, visual effects, renting or leasing facilities or equipment, renting or leasing motor vehicles, food, lodging, and any other similar expenditure as determined by Commerce. "Production expenditures"

would also include expenditures for (a) music that is performed, composed, or recorded by a musician who is a resident of the state, or published, or distributed by an entity that has its headquarters in the state; (b) air travel that is purchased from a travel agency or company that has its headquarters in the state; and (c) insurance that is purchased from an insurance agency or company that has its headquarters in the state. "Production expenditures" would not include expenditures for the marketing and distribution of an accredited production.

An eligible claimant would be a film production company that operates an accredited production in the state. The company must own the copyright in the accredited production, or have contracted directly with the copyright owner, or a person acting on the owner's behalf, and the company must have a viable plan for the commercial distribution of the finished production as determined by Commerce.

The Department of Revenue (DOR) would administer tax credit claims and could take any action, conduct any proceeding, and act as authorized under income and franchise tax provisions relating to change of business, timely claims, assessments, refunds appeals, collection, interest, and penalties.

Film Production Company Investment Tax Credit. An eligible claimant could claim as a credit against individual and corporate income and franchise taxes, for the first three tax years that the claimant was doing business in the state as a film production company, an amount that was equal to 15% of the following that the claimant paid in the tax year to establish a film production company in Wisconsin:

a. The purchase price of depreciable, tangible personal property. The claimant must purchase the tangible personal property after December 31, 2005, and at least 50% of the property's use must be in the claimant's business as a film production company. Unused tax credit amounts could be carried forward up to fifteen years to offset future tax liabilities.

b. The amount expended to acquire, construct, rehabilitate, remodel, or repair real property. A claimant could claim a credit for an amount expended to construct, rehabilitate, remodel, or repair real property, if the claimant began the physical work of construction, rehabilitation, remodeling, or repair, or any demolition or destruction in preparation for the physical work, after December 31, 2005, or if the completed project is placed in service after December 31, 2005. A claimant could also claim the credit for an amount expended to acquire real property, if the property is not previously owned property, and if the claimant acquires the property after December 31, 2005, or if the completed project is placed in service after December 31, 2005. Unused tax credit amounts could be carried forward up to fifteen years to offset future tax liabilities.

In order to claim a film production company investment tax credit, the Department of Commerce would be required to certify, in writing, that the credits claimed were for expenses related to establishing a film production company in the state. The claimant would have to submit a copy of the certification with the return.

Partnerships, limited liability companies (LLCs), and tax-option corporations (S corporations) could not claim the tax credit, but eligibility for and the amount of the credit would be based on the entity's allowable investments as described above. A partnership, LLC, or tax-option corporation would be required to compute the amount of the tax credit each of its partners, members or shareholders could claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations would claim the credit in proportion to their ownership interest.

"Film production company" would be defined as an entity that creates films, videos, electronic games, broadcast advertisement, or television productions, not including the productions specifically excluded under the definition of "accredited production" used for the film production services tax credit (described above). "Physical work" would not include preliminary activities such as planning, designing, securing financing, researching, developing specifications, or stabilizing property to prevent deterioration. "Previously owned property" would mean real property that the claimant or a related person owned during the two years prior to doing business in the state as a film production company, and for which the claimant could not deduct a loss from the sale of the property to, or an exchange of the property with, the related person as defined under the federal IRC.

DOR would administer tax credit claims and could take any action, conduct any proceeding, and act as authorized under income and franchise tax provisions relating to change of business, timely claims, assessments, refunds appeals, collection, interest, and penalties.

SENATE AMENDMENT 1

Senate Amendment 1 would specify a number of administrative responsibilities for the Department of Commerce relating to the film production services and film production company investment tax credits. Commerce would be required to implement a program for accrediting productions for the purpose of claiming the tax credits. Applications for accreditation would have to be made to Commerce in each year for which accreditation was desired. If the Department accredited a production, it would be required to determine the amount of production expenditures that would be eligible for the film production services tax credit. Commerce would have to notify DOR of every film production that was accredited, and the amount of production expenditures eligible for a tax credit. Commerce, in consultation with DOR would be required to promulgate rules to administer the tax credits.

FISCAL EFFECT

The estimated fiscal effects of the film production services and film production company investment tax credits are based on information provided by DOR, the Department of Tourism, and individuals and companies currently active in the Wisconsin film industry.

Film Production Services Tax Credit. The film production services tax credit would provide a nonrefundable tax credit under the state individual and corporate income and franchise taxes equal to the following expenses for an accredited film production conducted in Wisconsin: (a) 25% of the salary and wages of resident employees; and (b) the state sales taxes paid on the purchase of tangible personal property and services used directly in the production. In addition, a refundable credit equal to 25% of production expenses of an accredited production would also be provided. The credit could be claimed for tax years beginning after December 31, 2005. Because a portion of the production services tax credit (production expenses) is refundable, the credit would both reduce state tax revenues and increase GPR expenditures. It is estimated that the film production services tax credit would reduce state individual and corporate income and franchise taxes by \$150,000 in 2005-06 and by \$250,000 in 2006-07. In addition, GPR expenditures would increase by an estimated \$250,000 in 2005-06 and \$750,000 in 2006-07.

Film Production Company Investment Tax Credit. The film company investment tax credit would provide a credit under the individual and corporate income and franchise tax equal to 15% of: (a) the purchase price of depreciable, tangible, personal property; and (b) the amount expended to acquire, construct, rehabilitate, remodel, or repair real property. The credit could be claimed for tax years beginning after December 31, 2005. The film production company investment tax credit would reduce state income and franchise tax revenues by a minimal amount in 2005-06 and 2006-07.

Senate Amendment 1. The Department of Commerce has indicated that it could absorb the cost of administering the film production services and film production company tax credits with existing resources, including staff. Consequently, the SSA 1 would have no fiscal effect.

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