

# Motion Picture Production Tax Incentives Program



**ARIZONA DEPARTMENT OF COMMERCE**  
*Our Job is JOBS!*

Annual Report - Calendar Year 2006

January 2007

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## Incentive Overview

### Background

The Motion Picture Production Tax Incentives Program was established by the Arizona Legislature in 2005 to promote and stimulate the motion picture industry in Arizona (A.R.S. §41-1517). The program achieves this goal by providing tax incentives to qualified motion picture production companies (qualified company). The Arizona Department of Commerce (Commerce) accepts applications year round, on a first come, first served basis and determines eligibility for program incentives. A company may be qualified for a twelve-month period if it:

1. Is primarily engaged (more than 50%) in producing motion pictures,
2. Has a physical office and bank account in Arizona,
3. Begins production within four-months of pre-approval,
4. Anticipates incurring qualifying production costs of at least \$250,000 in the twelve-month pre-approval period, and
5. Estimates employing Arizona residents during production activities as follows:

| <u>Year</u> | <u>Percent</u>   |
|-------------|--|
| 2006        | 25% of the full-time employees must be Arizona residents |
| 2007        | 35% of the full-time employees must be Arizona residents |
| 2008        | 50% of the full-time employees must be Arizona residents |

The following is a brief summary of the seven incentives provided by the Motion Picture Production Tax Incentives Program to a qualified company beginning January 1, 2006.

#### Transaction Privilege Tax Exemption on:

- o machinery, equipment and other tangible personal property used directly in the motion picture (A.R.S. §§42-5061(B)(23) and 42-5071(B)(2)(b)).
- o job printing, engraving, embossing or copying that will be used directly in production (A.R.S. §42-5066(B)(4)).
- o leases or rentals of lodging space (A.R.S. §42-5070(C)(2)).
- o catered food, drink and condiments (A.R.S. §42-5074(B)(10)).
- o construction contracts associated with production (A.R.S. §42-5075(B)(20)).

Use tax exemption on machinery, equipment and other tangible personal property (A.R.S. §42-5159(B)(23)).

Income tax credits used to offset Arizona tax liability. Arizona statutes provide transferable income tax credits of \$30-\$70 million depending on the calendar year in which application is made. Tax credit allocations for a motion picture production

are based on Arizona expenses directly attributable to the production and are equal to:

| <u>Credit</u> | <u>Qualifying Production Costs</u> |
|---------------|------------------------------------|
| 10%           | \$250,000 - \$1,000,000            |
| 15%           | \$1,000,001 - \$3,000,000          |
| 20%           | More than \$3,000,000              |

The tax credits may be used, sold or transferred; unused tax credit amounts may be carried forward for up to five taxable years (A.R.S. §§43-1075 and 43-1163).

### **Reporting Requirements**

A.R.S. 41-1517(M) requires Commerce to prepare and publish an annual report of the following information collected under this program:

1. Information provided on applications for motion picture production tax incentives. These records shall reflect a percentage comparison of the annual amount of monies exempted or credited to qualifying motion picture production companies to the estimated amount of monies spent on in-state production costs by motion picture production companies.
2. Annual data on growth in Arizona-based motion picture industry companies and motion picture industry employment and wages.

## **Data Analysis**

### **Application Activity**

Commerce received thirty-three applications from sixteen production companies during calendar year 2006. Twelve applications were either withdrawn by the companies or denied pre-approval by Commerce. Further, tax credit allocations were voluntarily relinquished for three applications.

Commerce pre-approved the remaining eighteen applications, which came from eleven companies for \$30 million in tax credits. The eleven pre-approved companies estimated employing 2,276 full-time employees on their 25 productions. The companies estimated that 1,716 employees (or 75% of all full-time employees) will be Arizona residents. It should be noted no information is available regarding the full-time equivalency of these positions at this time.

The pre-approved companies anticipate spending over \$232 million on the productions, with over \$167 million being spent in Arizona.

### **Production Activity**

Production volume data was requested from the three largest film offices in Arizona. However, due to a staff vacancy at the Phoenix office, no data was reported to ADOC. Based on the data provided by Tucson and the Arizona Department of Commerce Film Office, combined activity appears to have increased

in each performance measure category from 2005 to 2006 (the inception of the tax incentive program):

Number of project shot statewide: up 48% from 2005 to 2006.

Projects Shot – Encompasses a wide variety of production types identified as part of the Visual Arts or Motion Picture Industry. The following projects are currently tracked: Feature Film, Commercial, Documentary, TV, Still/Catalog, Student Films, Industrial, Music Video, Multi Media/New Media, and Other/Unclassified.

Number of “qualified” project inquiries: up 53% from 2005 to 2006.

Qualified Project Inquiries - These are leads that have contacted the Film Office seeking a location to begin, resume, and/or complete production of their project.

Number of production days: up 6% from 2005 to 2006.

Production Days – The number of days a production company is established in state to begin, resume, or complete a project. The count stops when a project “wraps” production in state and is no longer using Arizona as a location or primary base of operations for the identified project.

| <b>ADOC FILM OFFICE</b>               | <b>FY04</b> | <b>FY05</b> | <b>FY06</b> |
|---------------------------------------|-------------|-------------|-------------|
| Number of projects shot               | 29          | 59          | 100         |
| Number of qualified project inquiries | 302         | 300         | 460         |
| Number of production days             | 500         | 600         | 632         |

| <b>TUCSON</b>                         | <b>FY04</b> | <b>FY05</b> | <b>FY06</b> |
|---------------------------------------|-------------|-------------|-------------|
| Number of projects shot               | 51          | 52          | 64          |
| Number of qualified project inquiries | 228         | 182         | 277         |
| Number of production days             | 237         | 268         | 286         |

| <b>SUB-TOTAL **</b>                   | <b>FY04</b> | <b>FY05</b> | <b>FY06</b> |
|---------------------------------------|-------------|-------------|-------------|
| Number of projects shot               | 80          | 111         | 164         |
| Number of qualified project inquiries | 530         | 482         | 737         |
| Number of production days             | 737         | 868         | 918         |

\*\* excludes Phoenix film office due to lack of available data

### **Credits vs. Spending**

For the purposes of the following discussion, the three tax credits and exemptions authorized under the program are broken into two categories – spending *within the State related to the production* (the income tax credit and TPT exemption) and spending *outside of the State for goods and services that are used in Arizona during the production* (use tax). All figures are based on estimates from the applicants submitted at the time of application. The actual amount of spending will be attested to in the applicants' Completion Reports required to be submitted to Department of Commerce, possibly starting as early as February 2007.

Credits/Exemptions for In-state spending: For CY 2006, pre-approved applications show spending *in Arizona* related to productions is projected to be \$167,015,540. The total approved, potential credits and exemptions associated with this level of spending within Arizona is \$40,521,979, as shown below.

| <b>Approved, Potential Tax Credits and Exemptions for In-state Spending</b> |               |
|---|---------------|
| <i>Type of Incentive</i>  | <i>Credit</i> |
| Income Tax Credits  | \$30,000,000* |
| TPT Exemptions**  | \$10,521,979  |
| Total   | \$40,521,979  |

- \* 2006 cap on amount of income tax credits available; established by A.R.S. §41-1517(E)
- \*\* Total potential TPT exemptions; estimated in-state spending times 6.1% TPT rate

Exemptions for Out-of-state spending: In addition, pre-approved applications show projected spending of \$65,338,049 *outside Arizona* for goods and services that will be used in-state during a production. Based on use tax of 5.6%, this equates to approved, potential exemptions of \$3,658,931:

| <b>Approved, Potential Tax Exemptions for Out-of-state Spending</b> |             |
|---|-------------|
| Use Tax Exemptions***   | \$3,658,931 |

- \*\*\* Total potential use tax exemptions; estimated production costs outside of Arizona times 5.6% use tax rate

Total potential credit/exemptions: The total amount of approved, potential tax credits and exemptions is estimated at \$44,180,910 for CY 2006. Actual dollar amounts of tax credits will not be available until tax returns are submitted to the Arizona Department of Revenue upon completion of production. The final amount of tax credits may be lower than the estimate if some credits are not claimed. Further, transaction privilege and use tax exemptions will not be known until the Department of Revenue begins collecting the data, which anticipated for the February 2007 reporting period.

It should be noted the figures shown above are merely estimates of planned spending and do not reflect the economic impact of the motion picture tax incentives. An econometric analysis is required to determine this impact, including

the number of direct, indirect and induced jobs created, industry output, and most importantly, the amount of state and local taxes generated or the actual “return on investment” for the program. It is anticipated an economic impact analysis will be performed when adequate data has been amassed.

**Industry Growth Data (2005 – 2006)**

In December 2004, industry codes under the North American Industry Classification System (NAICS) were identified in an economic impact analysis of the State’s film industry performed for the Arizona Department of Commerce:<sup>1</sup>

- 51211 – Motion Picture and Video Production
- 51219 – Postproduction Services and Other Motion Picture and Video Industries
- 51212 – Motion Picture and Video Distribution

To determine changes to statewide employment in the film industry related businesses, the Arizona Department of Economic Security provided information from the Quarterly Census of Employment and Wages (QCEW) for these three codes. The QCEW data includes both companies and sole proprietors. The following table combines the three NAICS sectors into one group. This data shows annualized quarterly data. It should be emphasized that NAICS codes are self-reported by employers to DES.

| <b>Arizona Motion Picture and Film Industry – Annual Employment and Wages</b> |                             |                |                           |                |                         |                        |                |                                 |                |
|---|-----------------------------|----------------|---------------------------|----------------|-------------------------|------------------------|----------------|---------------------------------|----------------|
| Year/ Qtr.  | Average # of Establishments | Annual Change* | Average Annual Employment | Annual Change* | Avg. Employees Per Firm | Total Industry Wages** | Annual Change* | Average Annual Employee Wage*** | Annual Change* |
| 2006/3  | 194                         | 10%            | 973                       | 30%            | 5                       | \$29,433,393           | 9%             | \$30,258                        | -16%           |
| 2006/2  | 188                         | 7%             | 978                       | 35%            | 5                       | 28,643,598             | 3%             | 29,303                          | -24%           |
| 2006/1  | 183                         | 4%             | 935                       | 34%            | 5                       | 27,759,647             | -1%            | 29,705                          | -26%           |
| 2005/4  | 179                         | 0%             | 826                       | 13%            | 5                       | 26,454,898             | -7%            | 32,037                          | -18%           |
| 2005/3  | 176                         | -2%            | 751                       | 7%             | 4                       | 27,048,441             | 4%             | 36,029                          | -2%            |

Source: DES, January 15, 2007

\* Change from the same quarter in prior year

\*\* Industry wages represent a rolling 3-month accumulation

\*\*\* Change in average annual employee wages from the same quarter in prior year

<sup>1</sup> *Analysis of the Film and Video Industry in Arizona*, ESI Corporation, December 2004.  
<http://www.azcommerce.com/doclib/FILM/Analysis%20of%20the%20Film%20and%20Media%20Industr y%20in%20Arizona%2012.04%20B.pdf>

Firms and employees: The data indicates that the number of firms in the film related industries grew 10 percent from the 3<sup>rd</sup> quarter of 2005 (176 businesses) through the 3<sup>rd</sup> quarter of 2006 (194 businesses). Over this same period, it appears employment also rose 30 percent, from 751 to 973 employees. However, the average number of employees stayed about the same at approximately 5 persons per reporting firm. No information is available regarding the full-time equivalency of these positions.

Wages: Total industry wages in the 3<sup>rd</sup> quarter of 2006 were up 9 percent, increasing from \$27.0 million to \$29.4 million. However, average annual employee wages declined in each quarter when compared to the same quarter in the year prior. The rate of decline accelerated from the 3<sup>rd</sup> quarter of 2005 (-2%) through the 1<sup>st</sup> quarter of 2006 (-26%). However, the rate of decline appears to have slowed through the 3<sup>rd</sup> quarter of 2006.

This decline appears to be a result of the number of employees rising faster than total wages paid for these sectors. In discussions with DES, it is not necessarily unusual for an industry with a high number of part time and contract workers to experience a decline in average employee annualized wages in periods of high growth. Additional periods of data will be needed to determine if this is merely a response to a sudden increase in industry activity in Arizona or if it is a long-term trend.

State and local taxes: At this time, Department of Revenue does not have available in its data systems records of corporate income tax payments for these detailed NAICS codes.