STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
EVOLUTIONARY PICTURES LLC **No. 16-01**
TO DENIAL OF FILM PRODUCTION TAX CREDIT
ISSUED UNDER LETTER ID NO. L1511552976

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on August 6, 2015 before Brian VanDenzen, Esq., Interim Chief Hearing Officer, in Santa Fe. At the hearing, Attorney R. Tracy Sprouls appeared representing Evolutionary Pictures, LLC ("Taxpayer"). Staff Attorney Peter Breen appeared representing the State of New Mexico Taxation and Revenue Department ("Department"). Protest Auditor Tom Dillon appeared as a witness for the Department. Taxpayer submitted a position statement into the record. The Department presented a published case. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On January 26, 2015, through letter id. no. L1511552976, the Department partially approved Taxpayer's claim for Film Production Tax Credit for $13,593,192.32 and denied the remaining portion of TP's claim for that credit.

2. On April 14, 2015, Taxpayer protested the Department's partial denial of the Film Production Tax Credit, arguing it was legally entitled to an additional claim of $1,280,166.52 under that credit.

3. On April 22, 2015, the Department's protest office acknowledged receipt of the protest.

4. On May 20, 2015, the Department filed a request for hearing in this matter with the Hearings Bureau[1].

5. On May 26, 2015, the Hearings Bureau sent Notice of Telephonic Scheduling Conference, scheduling this matter for a scheduling hearing on June 19, 2015.

6. On June 19, 2015, a Scheduling Conference Hearing occurred in this matter where the issues involved in the protest were discussed, the necessity of discovery and/or motions practice were discussed, and a merits hearing date was selected. The parties did not object that conducting the scheduling hearing satisfied the requirement that a hearing be set within 90-days of protest.

7. On June 22, 2015, the Hearings Bureau issued a Notice of Administrative Hearing in this matter, setting the merits hearing for August 6, 2015.

8. On July 17, 2015, Attorney Sprouls entered his appearance on behalf of Taxpayer.

9. Taxpayer is a movie production company that made the movie "Transcendence" in New Mexico.

10. Taxpayer purchased the acting services for out-of-state actors from the super loan-out company and payroll processing company named EPPSLO, Inc. ("EPPSLO").

11. EPPSLO had an office location in Albuquerque during the filming of the movie.

12. Taxpayer paid EPPSLO at least twenty million dollars for the services of the out-of-state actors, and received the maximum five-million dollar Film Production Tax Credit Act for those payments for performing artists' services.

[1] On July 1, 2015, pursuant to enacted Senate Bill 356, the Hearings Bureau became the Administrative Hearings Office ("AHO") independent of the Taxation and Revenue Department. *See* NMSA 1978, Section 7-1B (2015). The Hearings Bureau will be used for events that occurred before July 1, 2015, even though the hearing occurred before the Administrative Hearings Office and this decision is issued captioned under the Administrative Hearings Office.

13. In addition to paying for the performing artists' wages to EPPSLO, Taxpayer paid EPPSLO a payroll processing fee of $255,166.52 and reimbursed $1,025,000.00 in gross receipts taxes stemming from EPPSLO's receipt of the performing artists' wages from Taxpayer.

14. On February 3, 2014, Taxpayer filed an application for $14,071,215.00 in Film Production Tax Credit.

15. As discussed in finding of fact #1, the Department partially denied and partially granted Taxpayer's claim for the Film Production Tax Credit.

16. The Department denied $1,280,166.52 in claimed credit for Taxpayer's reimbursement of gross receipts tax and payroll processing fees to EPPSLO because Taxpayer had already maximized the credit for payment for the services of performing artists under Film Production Tax Credit Act.

DISCUSSION

The issue in this case is whether Taxpayer's payment to the super loan-out company EPPSLO are direct production expenditures subject to the general 25% cap or are direct production expenditures for the service of performing artists subject to a more specific five-million dollar cap under the Film Production Tax Credit. Since Taxpayer had already exhausted the five-million dollar cap for direct production expenditures for the service of performing artists, Taxpayer would not be entitled to any additional credit *if* the payments constituted direct production expenditures for the service of performing artists versus general direct production expenditures under the Film Production Tax Credit.

Burden of Proof.

Although the Department did not issue Taxpayer an assessment in this matter, Taxpayer still has the burden of establishing it was entitled to the claimed credit at issue. The New Mexico

Court of Appeals has found that tax credits are legislative grants of grace to a taxpayer that must be narrowly interpreted and construed against a taxpayer. *See Team Specialty Prods. v. N.M. Taxation & Revenue Dep't*, 2005-NMCA-020, ¶9, 137 N.M. 50 (internal citations omitted). Under the rationale of *Team Specialty Prods*, Taxpayer carries the burden of proving that it is entitled to the claimed credit. Nevertheless, although a credit must be narrowly interpreted and construed against a taxpayer, it still should be construed in a reasonable manner consistent with legislative language. *See Sec. Escrow Corp. v. State Taxation & Revenue Dep't*, 1988-NMCA-068, ¶9, 107 N.M. 540 (although construed narrowly against a taxpayer, deductions and exemptions—similar to credits—are still to be construed in a reasonable manner).

New Mexico Film Production Tax Credit

NMSA 1978, Section 7-2F-1.1 (2013, before 2015 amendment[2]) establishes the Film Production Tax Credit Act. That act allows for a tax credit in statutorily specified percentages for "direct production expenditures made in New Mexico" for eligible film production companies. *Id*. Under Section 7-2F-1 (B), the credit is generally capped at 25% of direct production expenditures unless otherwise specified under that section.

The more specific cap at issue in this case is contained under Section 7-2F-1 (S). Section 7-2F-1 (S) (emphasis added) states that

> [a]s applied to direct production expenditures *for the services of performing artists*, the film production tax credit authorized by this section shall not exceed five-million dollars ($ 5,000,000) for services rendered by all performing artists in a production for which the film production tax credit is claimed.

As stated in the introduction, the question in this protest is whether the remaining amount of payroll processing fees and tax reimbursements Taxpayer paid to EPPSLO for the payment of

[2] Taxpayer's application for the credit occurred on February 3, 2014, before the passage and the effective date of the 2015 amendment to the Film Production Tax Credit. Thus, all references to the Film Production Tax Credit Act in this statute are to the 2013 version, before the 2015 amendments.

performing artists' fees falls under the Section 7-2F-1 (S) cap or are subject to the general 25% credit for direct production expenditures. In this case, Taxpayer received the maximum five-million dollar credit for its payment of performing artists fees to EPPSLO, meaning that if the additional payroll processing fees and tax reimbursements made to EPPSLO constitute expenditures for the services of the performing artists, Taxpayer cannot obtain any additional amount of credit under the Section 7-2F-1 (S) cap. The Department argued that all the fees Taxpayer paid to the super loan-out company, including the payroll processing fees for processing the artist's payments, are subject to the already exhausted five-million dollar cap found under Section 7-2F-1 (S), because all of the payment were "direct production expenditures for the services of performing artists." Taxpayer counters that these payroll processing fees and reimbursement of gross receipt tax were not payments to performing artists, but direct production expenditures subject to the general 25% cap under the Film Production Tax Credit. Thus, Taxpayer contends that the five-million cap under Section 7-2F-1 (S) does not apply and it is still entitled to the credit for the $1,280,166.52 payment to EPPSLO.

This disputed question turns on the language and construction of the Film Production Tax Credit Act. It is a canon of statutory construction in New Mexico to adhere to the plain wording of a statute except if there is ambiguity, error, an absurdity, or a conflict among statutory provisions. *See Regents of the Univ. of New Mexico v. New Mexico Fed'n of Teachers,* 1998-NMSC-20, ¶28, 125 N.M. 401. In *Wood v. State Educ. Ret. Bd.*, 2011-NMCA-20, ¶12 (internal quotations and citations omitted), the New Mexico Court of Appeals stated that

> the guiding principle in statutory construction requires that we look to the wording of the statute and attempt to apply the plain meaning rule, recognizing that when a statute contains language which is clear and unambiguous, we must give effect to that language and refrain from further statutory interpretation.

Extra words should not be read into a statute if the statute is plain on its face, especially if it makes sense as written. *See Johnson v. N.M. Oil Conservation Comm'n*, 1999-NMSC-21, ¶ 27, 127 N.M. 120; *see also Amoco Prod. Co. v. N.M. Taxation & Revenue Dep't, 1994-NMCA-086*, ¶8 & ¶14, 118 N.M. 72. Only if the plain language interpretation would lead to an absurd result not in accord with the legislative intent and purpose is it necessary to look beyond the plain meaning of the statute. *See Bishop v. Evangelical Good Samaritan Soc'y*, 2009-NMSC-036, ¶11, 146 N.M. 473. Because this case also involves a tax credit, which has been found to be an act of legislative grace, the language of the credit statute must be narrowly constructed. *See Team Specialty Prods*, 2005-NMCA-020, ¶9.

Applying these principles to the disputed credit, the plain language of Section 7-2F-1 (S) (emphasis added) indicates that payment "…*for* the services of performing artists" is subject to the five-million dollar cap. As the Department argued, rather than indicating payments "to" performing artists, as Taxpayer's interpretation would require, the statute used the word "'for' the services of performing artists." To change the reading of the tax credit by either adding or replacing a word in the statute is not consistent with the rules of construction of a tax credit, as articulated by *Team Specialty Prods*, 2005-NMCA-020, ¶9. Thus, Section 7-2F-1 (S) must be read narrowly consistent with the plain language contained in the statute: the amount of credit for direct production expenditures *for* the services of performing artists is capped at five-million dollars.

While Taxpayer's payment of payroll processing fees and reimbursement of gross receipts tax on the artists' fees were certainly not payments to the artists themselves, they were part of the payment *for* the services rendered by the performing artists. All of the payments that Taxpayer made to the super loan-out company EPPSLO were to pay *for* the services of the

performing artists. The administrative payroll processing fees and gross receipts tax liability reimbursement stemming from payment of the performing artists' wages would not have been required but for the fact that Taxpayer made the decision, apparently consistent with industry practice, to pay the performing artists' fees through the super loan-out company. In other words, rather than being independent direct production expenditures, those costs are ancillary to Taxpayer's payment "for the services of performing artists" through the super loan-out company. While these costs do qualify for the Film Production Tax Credit, since these payments are part and parcel of using the super loan-out company for the payment of performing artists' service, they only qualify up to the five-million dollar cap under Section 7-2F-1 (S) for services rendered by the performing artists.

Taxpayer's interpretation also espouses an inconsistent reading of the phrase "direct production expenditures" for one beneficial purpose but not for another detrimental purpose. Taxpayer argued that even if the payment may have been for the service of the performing artists, those payments did not qualify as "direct production expenditures" for the purposes of Section 7-2F-1 (S) and thus were not subject to the five-million dollar cap imposed by that subsection. Yet, Taxpayer argued that these payments did constitute "direct production expenditures" eligible for the general 25% cap for the remaining portions of the Film Production Tax Credit Act. While Taxpayer's brief cited NMSA 1978, Section 7-2F-1 (T) (1) (2015) for the definition of "direct production expenditures," under the 2013 version of the Film Production Tax Credit Act applicable to Taxpayer's application for the credit, that definition is actually found under NMSA 1978, Section 7-2F-2 (C) (2013, before 2015 amendment). Generally, this definition between the 2013 amendment and the 2015 amendment is similar, but the 2013 version does not include example #10 for audit

costs cited in Taxpayer's position statement and oral argument. Thus, that portion of Taxpayer's argument related to example #10 for audit costs will not be addressed.

In pertinent part, under Section 7-2F-2 (C), "direct production expenditures" means

> (1) except as provided in Paragraph (2) of this subsection, means a transaction that is subject to taxation in New Mexico, including:
>
> (a) payment of wages, fringe benefits or fees for talent, management or labor to a person who is a New Mexico resident;
> …
> (c) payment to a personal services business for the services of a performing artist if: 1) the personal services business pays gross receipts tax in New Mexico on the portion of those payments qualifying for the tax credit; and 2) the film production company deducts and remits, or causes to be deducted and remitted, income tax at the maximum rate in New Mexico pursuant to Subsection H of Section 7-3A-3 NMSA 1978 on the portion of those payments qualifying for the tax credit paid to a personal services business where the performing artist is a full or part owner of that business or subcontracts with a personal services business where the performing artist is a full or part owner of that business; and
>
> (d) any of the following provided by a vendor: 1) the story and scenario to be used for a film; 2) set construction and operations, wardrobe, accessories and related services; 3) photography, sound synchronization, lighting and related services; 4) editing and related services; 5) rental of facilities and equipment; 6) leasing of vehicles, not including the chartering of aircraft for out-ofstate transportation; however, New Mexico-based chartered aircraft for in-state transportation directly attributable to the production shall be considered a direct production expenditure; provided that only the first one hundred dollars ($ 100) of the daily expense of leasing a vehicle for passenger transportation on roadways in the state may be claimed as a direct production expenditure; 7) food or lodging; provided that only the first one hundred fifty dollars ($ 150) of lodging per individual per day is eligible to be claimed as a direct production expenditure; 8) commercial airfare if purchased through a New Mexico-based travel agency or travel company for travel to and from New Mexico or within New Mexico that is directly attributable to the production; 9) insurance coverage and bonding if purchased through a New Mexico-based insurance agent, broker or bonding agent; and 10) other direct costs of producing a film in accordance with generally accepted entertainment industry practice…

Under the 2013 version of the statute, there is no conflict between Section 7-2F-2 (C)'s definition of "direct production expenditures" and Section 7-2F-1 (S) use of that phrase. Section 7-

2F-1 (S) refers to those "direct production expenditures" related payments for the services of the performing artists. In other words, Section 7-2F-1 (S) uses the same definition for "direct production expenditures" found throughout the Film Production Tax Credit Act, but imposes a specific cap for those "direct production expenditures" attributable to payment of performing artists. Since there is no inconsistency between the use of those terms, under general principles of statutory construction and under the *Team Specialty Prods*, 2005-NMCA-020, ¶9 requirement to read a credit statute narrowly, Taxpayer's argument that its payments do not qualify as "direct production expenditures" for one purpose under Section 7-2F-1 (S) but does qualify as "direct production expenditures" for another more beneficial purpose under the general credit is not persuasive.

Taxpayer may certainly claim a credit for the fees it paid the super loan-out company, but only up to the five-million dollar cap contained under Section 7-2F-1 (S) because those fees are part of the payment "for services of performing artists." Because Taxpayer's claim for credit had already exhausted the five-million dollar cap under Section 7-2F-1 (S) and because the additional disputed claim for credit is for fees and reimbursements associated with payment for services of the performing artists, the Department properly denied that portion of Taxpayer's claim for Film Production Tax Credit.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's denial of the claim for credit, and jurisdiction lies over the parties and the subject matter of this protest.

B. Holding the June 19, 2015 Scheduling Hearing and setting a merits hearing date at that time satisfied the 90-day hearing requirement of NMSA 1978, Section 7-1-24.1 (A) (2013).

C. The Film Production Tax Credit is capped at five-million dollars under Section 7-2F-1 (S) for the payments for the services of performing artists.

D. Under the language of Section 7-2F-1 (S), Taxpayer's payment of processing fees and reimbursement of gross receipts tax for its payment of artists fees through EPPLO, Inc. constitute payments *for* the services of performing artists. *See Team Specialty Prods. v. N.M. Taxation & Revenue Dep't*, 2005-NMCA-020, ¶9, 137 N.M. 50 (Tax credits are legislative grants of grace to a taxpayer that must be narrowly interpreted and construed against a taxpayer).

For the foregoing reasons, the Taxpayers' protest **IS DENIED**.

DATED: February 8, 2016.

Brian VanDenzen
Interim Chief Hearing Officer
Administrative Hearings Office
P.O. Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (1989), the parties have the right to appeal this decision by *filing a notice of appeal with the New Mexico Court of Appeals* within 30 days of the date shown above. *See* Rule 12-601 NMRA. If an appeal is not filed within 30 days, this Decision and Order will become final. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may being preparing the record proper.