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The biz's taxing situation

Net benefit of incentive programs is complicated, controversial

By TODD LONGWELL

The vast majority of industryites -- from left-leaning opponents of corporate welfare to right-leaning anti-government types -- seem to agree on one thing: Domestic production incentives -- which are offered in 40 U.S. jurisdictions, including Puerto Rico and the District of Columbia -- are good news for them and for their local economies, and it's not hard to see why. On the surface, attractive incentives lure Hollywood productions that create jobs and spend money in the communities.

But the net benefit of incentive programs is complicated, controversial and frequently misunderstood.

Since 1997, when incentives began to appear in Canada, California's concentration of film employment has slipped from 4.4 times the national average to less than 3.7 times today, according to a study by the Milken Institute released in June 2012. An analysis of U.S. Bureau and Labor Statistics data reveals that the state's share of employment and wages for motion picture and video production fell 4% to 54% in 2011, from 58% in 2002, the year Louisiana and New Mexico heated up the production incentive race in the U.S.; 3% of that drop has occurred since 2009, the year California enacted its incentive.

The California offset is a relatively small 20%-25%, and comes with a $100 million annual cap, along with a host of restrictions.

"It's such a challenge chasing the tax credits," says Jules Roman Tippett, president and CEO of f/x house Tippett Studios in Berkeley, Calif. "Why our state can't join that race, I don't know."

According to Jason Sisney, of California's Legislative Analyst's Office, the answer is based on the sheer size of the biz in the state. "California's film and television industries are so large that it would be cost prohibitive to have a very broad-based credit applying to most productions," he says. "So (we have) this very limited one."

A 2011 study by the Los Angeles County Economic Development Corp. (LAEDC) sponsored by the MPAA, backs that up: California generates 39% of all U.S. employment in the motion picture and video industries; 60% ($15.5 billion) of U.S. labor income in the industry is earned in the state. And while overall percentages have fallen, when it comes to raw jobs numbers, California has actually seen a slight uptick over the past few years, from 108,104 jobs in 2002 to 108,244 in 2011.

California's incentive is carefully designed to attract productions that would not otherwise shoot there. Features, telepics, miniseries and new television series for basic cable receive 20% for qualifying in-

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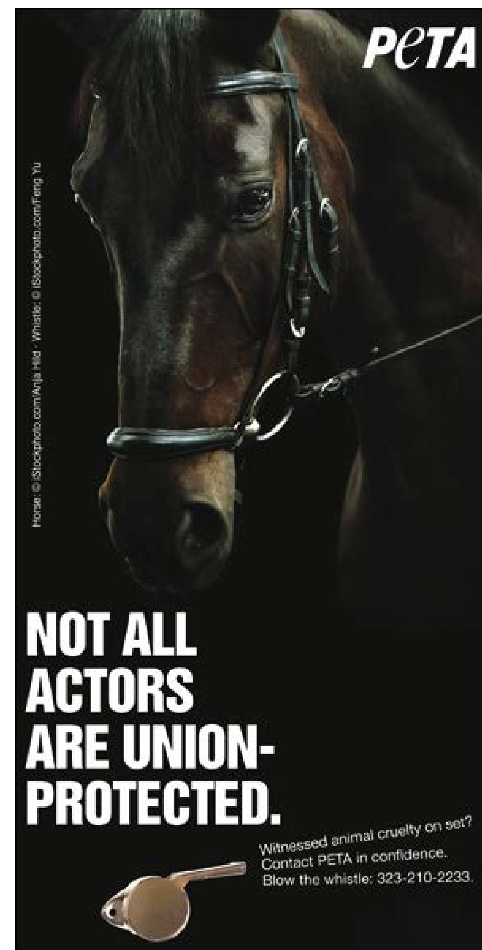

state spending. Features with budgets of more than $75 million are ineligible, as are network and premium-cable series, unless they are relocating from another state (e.g. ABC's "Body of Proof," which moved from Rhode Island to Los Angeles this season). Relocating series receive a 25% credit, the same as for independent films.

In contrast, recipients of New York State's 30% tax credit include shows such as NBC's 37-year-old "Saturday Night Live," which is unlikely to leave Manhattan's 30 Rockefeller Center prior to the next ice age or its cancellation, whichever comes first.

One of the biggest misconceptions about such credits is that is they simply reduce a production's tax burden, according to Adrian McDonald, author of the study Down the Rabbit Hole: Runaway Productions & Hollywood Economics. In virtually all the popular runaway production locations, the credits operate as cash, McDonald says.

When New Mexico Gov. Susana Martinez came into office in January 2011, vowing to cut the state's refundable tax credit (in the end, it was capped at $50 million a year), supporters of the credit railed against the subsidies for the oil and mining industries, McDonald says. But the oil and mining companies get tax breaks or abatements -- a reduction in what they owe -- whereas film and TV productions get 25% back on qualified expenses directly from the state, regardless of their in-state tax burden, McDonald adds.

Similarly, Louisiana offers a 30%-35% transferable credit that can be sold back to the state for 85¢ on the dollar or to a broker who will in turn sell them to corporations or wealthy individuals. Like many credits, Louisiana's can be applied to all wages paid in-state, with an extra 5% given for resident wages.

In California, only resident wages are eligible for the offset. Unlike most other states, its credit is also non-refundable and non-transferable, except for films with budgets of less than $10 million made for companies that aren't publicly traded. (This proviso is not the turn-off it would be in other regions, because studios have large tax burdens in the state.)

While industryites in California decry the stinginess of the incentives, taxpayers might be grateful they're not as high as in other states.

A study by the nonprofit Louisiana Budget Project found that state's uncapped program paid $231 million to productions in 2011-12, bringing the state's total film and TV spending to more than $1 billion over the past decade, with taxpayers shelling out more than $60,000 per direct job created by the incentive.

Still, proponents would argue, and most opponents would concede, that the net number of credit dollars shelled out for each job is not the full measure of an incentive's effectiveness. One must also take into account a credit's multiplier effect -- the indirect spending and induced spending that such credits create. The idea is that money spent in restaurants, hotels and other businesses on a shoot moves on through other sectors of a state's economy.

"The multipliers are calculated using a state-specific economic model called 'input-output,' which tracks business transactions between industries and household," says Andrew Phillips, senior manager of quantitative economics and statistics for Ernst & Young, which has issued a number of reports on domestic film incentive programs. For example, the models used in these studies and others shows that for each dollar of film production spending, some is spent on labor, some on

purchases of supplies and materials from in-state firms, and some on purchases from out-of-state businesses, Phillips says.

In 2011, Ernst & Young released a study examining the first two years (2009-2010) of the Michigan tax credit, which at the time was the richest in the country, topping out at 42%. It found that the after factoring in increases in state and local taxes and fees, and reductions in unemployment payments, there was a net loss in tax revenue of 72¢ for every dollar of credit issued. But when all the multipliers were calculated, each dollar of net tax credit generated $5.92 in new Michigan business sales and $2.05 in additional resident income over the course of two years.

The multipliers vary greatly in size, depending on the industry -- film tends to get a middle-ground multiplier -- and the region.

"For example, in New York, the multiplier would be higher, because New York City is traditionally home to a very big entertainment, film and TV production cluster, so if it wins production back that it might've lost, there are a lot of people who'll benefit," says economist Robert Tannenwald, who authored a report critical of production incentives for the Center on Budget and Policy Priorities in 2010.

The same could be said of California, but experts disagree on the bottom line benefit of its incentive.

The LAEDC study found that for every dollar California spent on the tax credit, it saw a net return of $1.13 in increased economic activity or tax revenues. A February 2012 report by UCLA Institute for Research on Labor and Employment (UCLA-IRLE) analyzing the LAEDC's results, said a more accurate number would be $1.04, given that many films that applied for but didn't receive the credit shot in the state anyway.

In June, the staff of California's Senate Governance and Finance Committee issued an analysis of the LAEDC and UCLA reports that determined the incentive has a return closer to breakeven, and that in many years, the return may be well under $1, resulting in a net decline in state revenues.

Nevertheless, Sisney, one of the authors of the state study, says, "While we believe that (the LAEDC and UCLA) studies overstated the output-to-credit ratio, they do still show that there probably was some economic benefit that was generated." However, he warns, giving a tax break to some means that other businesses and individuals have to pay a bit higher tax rate than they would otherwise. "Or, alternatively, you have to cut back on other public programs you would ordinarily want to fund," he says.

Opponents of incentives argue that not enough weight is given to the negative multiplier effects of such cuts. For example, if a firehouse is shuttered, that has an adverse effect on those companies with whom it has been doing business in regards to income and ability to generate jobs, Tannenwald points out.

Often, the net effect of a production tax incentive is zero, and serves more to transfer money from taxpayers to the film industry and to those who immediately benefit from their spending. "The benefits are very concentrated. You can see them," Tannenwald says.

Others see those concentrated benefits as evidence incentives are working.

"I hear countless stories from legislators (who) have productions come to their districts (say) that the local cleaners that's doing $1,000 a day is all of a sudden doing $20,000 a day because of a wardrobe for a major motion picture," says Van Stephenson, senior vice president state legislative affairs for the MPAA, which lobbies in support of the incentives around the country.

Tourism is frequently touted as a major residual benefit of production, though it is generally not factored in as a multiplier. Studies show that a film has to be a relatively big success, be filmed in the place it's about, and feature iconic locations to get people to start contacting their travel agents, "like the bridges in 'The Bridges of Madison County, the Devil's Peak in 'Close Encounters of the Third Kind' and the baseball field in 'Field of Dreams,' " McDonald adds.

Michigan Film Office director Carrie Jones cites the 1980 film "Somewhere in Time," which has fans trekking to the Grand Hotel on Mackinac Island every summer to reenact scenes shot there, as such a movie. "We've seen firsthand that film tourism can really be a great boost," she says.

But these and most other films frequently cited as major tourism generators were typically filmed decades ago, pre-incentives, and drawn to the locations by their unique visual properties, not a tax credit. Today, runaway production sites typically stand in for other locales (e.g. "Battle Los Angeles" shot in Shreveport, La.), and film commissions make such visual versatility central to their sales pitch.

An overarching strategy behind production tax incentives, says Joseph Henchman, vice president of legal and state projects for the Tax Foundation, which opposes incentives, is that if a state manages to lure a production with a credit, and then a second production and a third, eventually an editing bay will pop up in that state, then a production studio, and then an industry that doesn't need to be subsidized any more. "But I don't think (the theory) bears out, because there is no loyalty from these traveling productions," Henchman says. "They are going to go wherever the incentive is the most generous.

A case in point is the Michigan Motion Picture Studios, where last year Disney shot "Oz: The Great and Powerful," which received a reported $39.96 million in tax credits from the state. Opened in April 2011, the $80 million complex was financed with more than $20 million in private equity (investors include William Morris Endeavor) and a wealth of federal and state money, including $18 million in bonds guaranteed by the State of Michigan Retirement Systems pension fund.

After Michigan Gov. Rick Snyder reduced the incentive's payout by more than 10% and capped its annual budget at $25 million last year, the tidal wave of production flowing into the state slowed to a trickle. A month after "Oz" (which was grandfathered in under the old rules) wrapped in early 2012, the studio had gone from employing 3,000 people to just 15 to 20.

The studio subsequently defaulted on its bond payments in February and August, and the pension fund had to cover them, first shelling out $420,00 and then $630,000.

In the wake of Snyder's cuts, Michigan lost "Iron Man 3" to North Carolina, which offers a 25% tax credit. North Carolina hosted "The Hunger Games" last year, but it lost the sequel to Georgia, which offers a 30% tax credit. Today, Michigan is back in the game with a film in its studio (New Line's "Black Sky"), and the cap now doubled to $50 million.

Some proponents of incentives contend that attacks on them are politically motivated, although the criticism comes from both the left (Center on Budget and Policy Priorities, Louisiana Budget Project) and the right (Tax Foundation, the Canadian Taxpayers Federation).

The MPAA's Stephenson, however, doesn't think the arguments against incentives, wherever they come from, are credible. "That's evidenced by the majority of states (that) continue to renew (credits) and prosper, and in their own analysis reveal that the incentives are working. Otherwise, they wouldn't continue to pass them."

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