# Made in America

4:45 PM PST 11/17/2009 by Todd Longwell, AP

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## The production incentives sweeping America may be less worthy than they appear

For years, the closest the city of Holland, Mich., got to big time show business was its annual Tulip Time Festival. That all that changed in April 2008 when the state enacted a film and TV incentive package highlighted by a refundable tax credit of up to 42% of in-state production spend and a 25% tax credit for film and digital media infrastructure investments.

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Shortly thereafter, TicTock Studios set up shop in a downtrodden neighborhood on the south side of town and started churning out low-budget films, first "Tug," starring Haylie Duff, then "Milk" screenwriter Dustin Lance Black's directorial debut "What's Wrong With Virginia," starring Jennifer Connelly and Ed Harris. Today, it occupies 10 structures within a two-block radius, including an old office building that has been turned into production and casting offices and a rundown transmission shop that has been cleaned up, painted bright red, and transformed into prop shop.

"It almost has that feel of an old Hollywood backlot, where everyone is milling around on bikes and golf carts," says TicTock CEO Hopwood DePree, a Holland native who spent a decade and a half in Hollywood as a struggling actor, writer and director before returning in 2007.

Clint Eastwood's "Gran Torino" (2008) was shot in Michigan.
The incentive has also drawn big Hollywood names to the state, from Clint Eastwood (2008's "Gran Torino") to Drew Barrymore (2009's "Whip It"), as well as California-based developer Jimmy Lifton, who last August broke ground on Unity Studios, a $146 million film, TV and new media production facility near Detroit.

It's an inspiring scene, one that the other 40 U.S. states currently offering significant production incentives would like to see playing out in their cities and municipalities. A recent survey by the Associated Press estimates that states gave $1.8 billion in tax breaks and other incentives to the entertainment industry from 2006-08, as they've progressively one-upped one another with more generous tax credits.

But with Michigan facing a $2.7 billion budget shortfall and other incentive states in similar dire economic straits, can they really justify the expense of these tax credits?

Increasingly, people are saying "no."

"The truth is, this is all being driven by film commissions that are having a party and filmophiles that are just getting off on this whole thing and it's not doing the states any good at all," says Schuyler Moore, a leading film tax attorney who authored the book "The Biz: The Basic Business, Legal and Financial Aspects of the Film Industry." "It's absolutely a complete boondoggle giveaway, and the concept of the states competing with each other to the lowest common denominator is on a policy level insane."

But what about those all those studies commissioned by states around the country that seem to endorse the economic benefit of the incentives? As with the proverbial inkblot test, people see what they want to see.

In July, the Massachusetts Department of Revenue reported its film incentive paid out $166 million in tax credits to film and TV productions from 2006-08, which in turn generated an estimated $302.3 million in new spending in the commonwealth. Nick Paleologos, executive director of the Massachusetts Film Office, sees it as proof positive of a successful program that has "exceeded everybody's expectations." For Massachusetts Taxpayers Foundation president Michael Widmer another statistic is more significant: For every dollar spent on the incentive, the commonwealth only sees a return of 16 cents in tax revenues.

"It's a heavy investment with a minimal return," Widmer says. "We have more films here now," including the upcoming action-comedy "Knight and Day," starring Tom Cruise and Cameron Diaz, "but we paid through the nose to get them here."

Paleologos argues that the tax credit wasn't supposed to raise tax revenue, it was designed to generate economic activity, and by that yardstick it has been a smashing success. Others strongly believe such activity is wildly overestimated in studies like these.

"I had one legislator who said to me, 'How can so many people look at the same issue and come up with such different conclusions?' " says David Zin, an economist with the nonpartisan Michigan State Senate Fiscal Agency. "Both the people who have been very in favor of the credits and the people who have been opposed to them have had a lot of trouble understanding what went into our analysis and other people's analyses."

States and municipalities often lure companies by offering to refund some of the taxes their business will generate. For example, a city might entice developers to build a hotel by agreeing to give them the occupancy tax charged to its guests for a period of 10 or 20 years. In the case of film incentives, the credit issued by the state generally dwarfs the tax bill generated by the visiting production. In most incentive states, the unused credit is monetized by selling it at a discount to third parties with large state tax burdens, from utility companies to wealthy individuals. In Michigan, the state writes a check directly to the production companies. Either way, the states are not merely forgoing revenue that never would've been generated had the production gone elsewhere.

Supporters of production incentives contend that this net loss is offset if not erased by the "multiplier effect," the economic ripple that occurs as a production's "direct spend" -- money paid to employees and various local businesses such as hotels, restaurants and car rental companies -- is spent again and again on goods, services and salaries, a process that is known as "indirect spend."

"Most of the studies that are out there place the multiplier for film activity being somewhere between one and a half and three," Zin says. "In other words, if you bring $100 million of activity to the state, it will generate somewhere between a total of $150 million and

$300 million in total activity."

Even if calculations for the multiplier effect are accurate, it doesn't mean the money is finding its way back into state coffers. Zin says the reason is that people only spend about 35%-45% of their income on things that are subject to the sales tax. The rest is saved, used it for things that aren't subject to tax, such as food and housing, or spent out of state.

"I think many legislators understand that credits don't generally pay for themselves," Zin says. "You do it because you feel like it's a positive thing to do."

One of the biggest positives is supposed to be job creation. A recent study by the Massachusetts Department of Revenue estimated that from 2006-08 production activity in the commonwealth (including commercials/advertising, television series and documentaries) generated 1,876 in direct new full-time equivalent jobs. Factor in the multiplier effect, and it created an another 1,300 jobs.

Widmer characterizes the number of jobs as "really tiny." "Even if you double or triple it, the industry still wouldn't register on the Richter Scale in terms of the Massachusetts economy," he says.

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They were also quite costly. Divide the $166 million Massachusetts spent on the tax credits by the number of jobs created and the cost is $52,267 per job with the multiplier effect and $88,386 per job without. Furthermore, Massachusetts residents only received 44% of the jobs and 18% of the wages.

Widmer and others contend that there are more positive things to do with a state's money like preserving teachers' jobs threatened by budget cuts. After all, the teachers will almost certainly be state residents and the salaries would also have a multiplier effect. And if Massachusetts must give out tax credits, Widmer argues, why not target biotech or another industry that is already organically embedded in the local economy, instead of chasing something as fickle and transitory as the film and TV business? He already knows the answer

"It's the Hollywood allure," Widmer says.

Ironically, Hollywood and the state it calls home are desperate to recapture some of that allure. According to the California Film Commission, the state's share of U.S. feature film production dropped from 66% in 2003 to 31% in 2008. The local indicators for television production are also down, with 57% of all TV pilots shooting in the L.A. area this year according to FilmL.A., down from 81% in 2004.

This year, California finally fought back with its 20%-25% tax credit, but it's narrowly targeted to projects that are seen as prime runaway production candidates, namely independent films, midrange budget studio pictures, miniseries, movies of the week and new series for basic cable. More significantly, the credit is nontransferable and nonrefundable in most cases (though it does have a five-year carry forward), meaning it can only be used to offset one's tax burden, and the state will not begin issuing credits earned this year until 2011.

In the meantime, California Film Commission director Amy Lemisch is looking for the competition to recede.

"I think that we're going to see some adjustments in terms of caps or annual limits or other refinements to their program," Lemisch says. "But that hasn't happened nearly as quickly as I thought it would."

"Cirque Du Freak: The Vampire's Assistant" (2009) was among the productions filmed in Louisiana.

Indeed, since Louisiana and New Mexico kicked off the domestic film incentive war in 2002, competitors have repeatedly assailed the programs as unsustainable, but they still reign as the model for states nationwide, attracting film after film large and small and significant outside investment in physical infrastructure (Albuquerque Studios, for example).

That's not to say there haven't been issues. In 2007, Mark S. Smith pled guilty to accepting $65,000 in bribes during his three-year tenure (2002-05) as director of the Louisiana Film Commission, but incentive program has continued to thrive. Not so in Iowa, where the governor recently suspended the state's 50% production tax credit when various irregularities came to light, including allegations the credit was used by filmmakers to pay for personal items such as luxury cars and feather beds.

Overall, efforts to scale back the incentives have been ineffectual. For every Wisconsin, which capped funding for its incentive at $500,000 per year back in July, there have been numerous other states that have increased their incentives during the past 18 months, including Alabama, Georgia, North Carolina, Ohio and Utah.

Meanwhile, while Canada continues to succeed in attracting a large share of productions, other countries such as Australia, Germany and the U.K. have become less attractive because of increased restrictions in their incentive programs and the continuing weakness of the U.S. dollar.

"I would not be surprised if (the dollar) declines 15%-20% against major currencies, meaning that the incentive to go to New Zealand, Australia, Germany, U.K. and Hungary will evaporate," says David Molner, founder and managing director of Screen Capital International, which specializes in securing cross-border tax-advantaged financing for major film productions.

The bottom line is, while the production incentives may be of questionable value to the states that offer them, they're still a boon for Hollywood dealmakers -- even those criticize them harshly.

"We absolutely love them," Moore says. "Because of the currency thing and the credits, it totally makes sense now to shoot in the U.S. It's become the haven."



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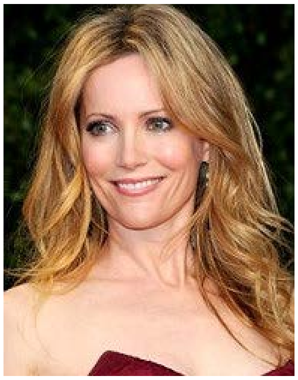


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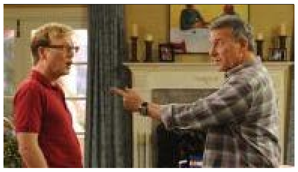

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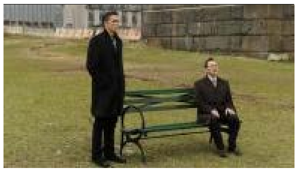

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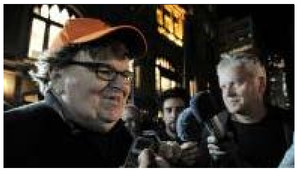

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