California Film & Television Tax Credit Program: A Brief Overview

I. <u>Purpose of the Tax Credit</u>

The film and television industries have traditionally been concentrated in California. Recently, the development of film and television production in other states and countries has negatively impacted film and television production in California.

According to the California Film Commission (CFC), sixty-six percent of studio features were filmed in California in 2003. By 2009, the percentage of studio features filmed in California had dropped to thirty-eight percent. San Francisco's film and television production employment fell forty-three percent alone between 2001 and 2006. The film and television industry has become a highly mobile industry as a result of advances in technology. The phenomenon of runaway production has become a hot button issue in California, with the Los Angeles Economic Development Corporation (LAEDC) estimating a loss of over 40 film productions, according to their January 2010 study entitled, *Entertainment and the Media in Los Angeles.* A recent example of movie magic is the new film, Battle: Los Angeles, which was actually filmed in Louisiana and used technology to make Louisiana look like Los Angeles.

It has also been argued that the relatively high cost of living in California and incentive programs offered by other states and countries have contributed to the flight of film and television production out of California. Industry flight is of concern to California because the film and television industry is a significant source of economic activity in California. It is estimated by the Motion Picture Association of America (MPAA) that the industry contributes $38 billion dollars annually to California's economy through tax revenue, jobs, and tourism. The MPAA also reports that the film and television industry supports 250,000 jobs.

II. The California Film and Television Tax Credit Program

1. Description of the Credit

In February 2009, the California Film & Television Tax Credit Program was enacted as a part of an economic stimulus plan to promote production spending, jobs, and tax revenues in California. The California Film & Television Tax Credit Program is administered by the CFC.

The credit first became available in July of 2009. Under existing statute, a qualified taxpayer is allowed a credit against income and/or sales and use taxes based on qualified expenditures. The credit amounts to either 20% or 25% of qualified expenditures, with a maximum of $500 million dollars allocated total over the life of the program. The credit cannot be used until January 1, 2011 and is not refundable. The credit may be carried over for five years and may be transferred to affiliates. Credits issued to independent films ($1 million- $10 million qualified expenditure budget that is produced by a company that is not publically traded and in which a publically traded company does not own more than 25% of the shares) may be transferred or sold to an unrelated party.

To be eligible for the credit, a project must meet the 75% test (production days or total production budget in California) and must be a qualifying motion picture.

For the purposes of a 20% tax credit, a qualifying motion picture is defined as:

- A Feature Film ($1 million minimum- $75 million maximum production budget);
- A Movie of the Week or Miniseries ($500,000 minimum production budget); or
- A new television series licensed for original distribution on basic cable ($1 million minimum budget, one-half hour shows and other exclusions apply)

For the purposes of a 25% tax credit, a qualifying motion picture is defined as:

- A television series, without regard to episode length, that filmed all of its prior seasons outside of California; or
- An independent film.

In the 2009-2010 fiscal year, which was the initial year of the program, $200 million was allocated. In each subsequent year until the 2013-14 fiscal year,

CFC will allocate $100 million. A minimum $10 million of the annual finding is made available for independent films.

2. Effectiveness of the Credit

With the current financial state of the California economy, all state programs affecting the General Fund are under scrutiny to ensure that the programs are effectively achieving desired results. Although the California Film & Television Tax Credit Program is a new program, substantial research has been published on tax film credits in general. Also, few reports specific to the California Credit have been issued.

The central goal of the California Film & Television Tax Credit Program is to prevent runaway production and retain production already being filmed in California. Whether the program has been successful in doing so is up for debate.

a. Proponents of the Credit

In January of 2010, the LAEDC projected that, as a result of the California incentive program, production in the state should have picked up in 2010. The projection by LAEDC was bolstered by Film L.A. (the permitting agency for Los Angeles) reports. Film L.A. reported that, in 2010, feature film production posted a 28.1% fourth quarter gain and a year-over-year gain of 8.1%. In Film L.A.'s January 11, 2011 release, it was reported that the increase can be wholly attributed to California's Film and Television Tax Credit Program. The program attracted dozens of new feature film projects to Los Angeles, which was responsible for 26% of the local feature production for the year. The CFC stated that these numbers are an early indicator that the incentive program is having an immediate positive impact on production in California.

The increase in production has resulted in increased revenues to the state as well as an increase in jobs. As reported by the CFC, in the 2009-10 fiscal year, $176 million in tax credits were allocated to 70 projects. The estimated aggregate direct spending by the 70 projects is $1.2 billion. That spending breaks down as follows: $453 million in direct qualified wages (excluded any wages for actors, directors, writers, and producers), $430 million in qualified non-wage expenditures and $346 million in non-qualified production expenditures (e.g. addition spending that does not qualify for tax credits). An estimated 18,200 crew and 4,000 cast members have been or will be hired by the approved projects and an additional 113,000 individuals will receive daily employment as background players.

While most of the filming activity occurs in Los Angeles County, several productions filmed, or plan to film, in Alameda, Inyo, Kern, San Bernardino, San Diego, and San Francisco counties.

In the 2010-2011 fiscal year, $121 million in tax credits were allocated to 43 projects. The estimated aggregate direct spending by the 43 projects is $969 million. Over $275 million is directly attributed to qualified wages and $315 million is in qualified non-wage expenditures. The balance of $379 million is attributed to non-qualified production expenditures. An estimated 7,500 crew and 2,100 cast members have been or will be hired by the approved projects and an additional 59,000 individuals will receive daily employment as background players.

To date, $300 million in tax credits have been allocated and this has resulted in a total aggregate of direct spending by the Program of $2.2 billion and total wages paid/to be paid of $728 million. Further, using generic multipliers for motion picture and video industries in California, the broader economic impact of the Film and Television Credit Program has resulted in business revenues of $6.5 billion, full time equivalent jobs of 40,996, and earnings of $1.8 billion.

Proponents also argue that California has a comparative advantage over other states because of the long established entertainment industry. The established industry has provided California with a skilled workforce and available infrastructure. The comparative advantage, when coupled with an incentive program, proves to be effective in keeping production in California, despite the fact that the California tax credit is not as generous as that of other states. In other words, an incentive program that is less costly than those provided in other states, has the ability to keep production in California because of the various other benefits connected with filming in California.

b. Opponents of the Credit

Opponents argue that, as a national policy, subsidies to the film and television industry create a race to the bottom. To stay competitive, states must continue to offer larger subsidies to keep production from running to another state. Runaway production may become detrimental to state revenue and may make the cost of the subsidy higher than the benefit received.

Opponents also argue that the subsidy benefits film and television production that would have occurred in absence of the incentive. The subsidy then becomes a revenue loss to the state. The revenue loss may be due in part to the distribution method used to allocate credits.

In the Legislative Analyst's Office (LAO) February, 2009 Film Production Credit section of the 2009-10 Budget Analysis Series, the LAO criticizes the distribution method of the credit. The credit is completely exhausted on the

first day the credit is made available through a lottery of those who applied on the first day. The LAO contends that this method of distribution undermines the stated goal of having production companies make a location decision based on the incentive. Instead, the LAO argues, projects already committed to production in California apply for the credits before other projects that are considering multiple locations and may have decided to stay in California but for missing the deadline to apply for the credit. The commitment must be decided before applying because upon allocation of the tax credit notification letter, production must commence within 180 days.

The second issue with the allocation method is horizontal inequity. Horizontal inequity results when similarly situated taxpayers are treated differently. Those ready to apply early are rewarded, while those still weighing their location options will miss out on the credit, and as a result, may decide to move production out of California.

Another potential costly issue with the Program is the transferable credit. The credits being sold to other taxpayers may result in revenue loss to the General Fund. The loss stems from the fact that companies that would otherwise have a tax liability to pay to the state can mitigate or eliminate the liability using the credit purchased from a qualified independent film. The credit can be sold to any company in any industry.

III. Conclusion

California is in a unique situation in comparison to other states offering film and television subsidies. The film and television industry has been a large source of employment and revenue for the state and losing the industry could be detrimental to the California economy. To ensure that the Film and Television industry continues to play a role in the California economy, a balancing of the needs of the industry and the California economy is required. The balance can be achieved by ensuring that the credit is targeted and effective.