Important Questions to Ask in Evaluating a Film Tax Incentive Program

Joseph Henchman

Vice President, Legal & State Projects, Tax Foundation

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Members of the Committee:

I thank you for the opportunity to speak with you and submit written testimony with regards to Senate Bill 23, which would extend the present state film tax credit ten years past its 2013 expiration date and caps total credits to be awarded at $200 million through 2023. We take no position on the bill but offer analysis based on our examination of film tax incentive programs generally in the United States.

For those unfamiliar with the Tax Foundation, we are a non-partisan, non-profit organization that has monitored fiscal policy at all levels of government since 1937. We have produced the Facts & Figures handbook since 1941, calculate Tax Freedom Day each year, and have a wealth of facts, rankings, and other information at our website, www.TaxFoundation.org. We have been widely cited for three major reports on film tax incentives:

- “More States Abandon Film Tax Incentives as Programs’ Ineffectiveness Become Apparent” (2011)

As these reports note, film tax incentive programs have exploded in recent years, growing from 4 states offering $2 million in 1999, to a peak of 40 states offering $1.4 billion in 2010. In the past few years, however, a record number of states are reconsidering, re-evaluating, or even outright de-funding, reducing, or eliminating their film incentive program. Michigan, most notably as it was one of the most generous incentive states, has sharply reduced their program. On the other hand, California, the state from which much of this television and film production was lured, adopted a new $100 million-a-year program in 2009 that most states are finding it hard to outbid. New York has also increased its program to $420 million per
year, and Louisiana, one of the first states to adopt a program, allocates over $100 million a year to it.

We find the economic evidence to compelling that these programs are a poor use of limited taxpayer dollars, because they are costly in the short-term and, in the long-term, are incapable of achieving the economic development goals their promoters often emphasize. However, for states that consider a film incentive to be a priority for their state’s resources, we offer three questions to be sure to ask.

**Question to Ask #1: What is the Purpose of the Film Tax Credit?**
Generally, states have adopted film tax incentives out of a desire to build a film industry in the state. Because California (and to some extent, New York) have already done this, and because most states are far behind early tax program adopters like Hawaii, Louisiana, and the Canadian provinces, this can be very difficult. Productions flock to whichever state offers the most generous incentive and leave as soon as another state offers a more generous one.

The underlying framework for film tax credits to build a permanent industry is therefore flawed. The idea is to subsidize each production as it flows through the state, in the hopes that enough productions will be cycling through, creating a critical mass that builds lasting infrastructure that in turn, at some future date, can survive successfully without ongoing state financial support of the industry. No state has achieved this economic development model with film tax incentives; the closest is Louisiana, which has seen substantial infrastructure investment but with no end in sight to annual state film incentive support. If Alaska wants sound stages, film studios, editing facilities, and other permanent infrastructure, it would be more direct and probably more effective to subsidize those projects directly rather than indirectly through individual productions.

The other primary justification for film incentive programs is pride: anger at seeing the state depicted in a movie or TV show that was filmed somewhere else, or at seeing the state depicted unfavorably. This concern is legitimate, to say the least, but if addressing it adequately requires millions of dollars that could otherwise go to more pressing public needs or left with taxpayers, it should be evaluated carefully.

**Question to Ask #2: What is the Revenue Impact?**
We sometimes hear that film tax incentives are a free lunch with no negative revenue impact, because the credit is only paid if new activity is generated that would not have occurred otherwise. This is misleading, because most film incentive programs (including Alaska’s) are either **transferable** or **refundable**, meaning that the credits do in fact reduce tax payments that would have been made in absence of the program. While film incentive beneficiaries were successful for many years at claiming a zero cost to these programs, much of the reason for recent state reconsideration has been the recognition that a billion and a quarter dollars might have better uses in times of tight state budgets than subsidizing one of the most profitable
industries in America. At minimum, legislators should view the credits paid against other possible uses for that tax money.

**Question to Ask #3: Is the Program Cost-Effective?**
Film tax incentives have been involved in serious scandals in a handful of states (including jail time for some), primarily due to limited auditing, evaluation, and legislative oversight of these programs. While categorized as a tax credit, these programs involve government officials awarding millions of dollars to selected and limited applicants with taxpayer resources for a public policy goal. All of these things should be measured and reviewed to police against waste, fraud, and abuse.

A crucial measure to program effectiveness is **incentive dollars spent per full-time equivalent (FTE) job created**. Beneficiaries often speak of the large numbers of jobs created by film incentive programs, but with many industry jobs lasting mere weeks, one must look at the FTE figures to evaluate effectiveness properly. Michigan’s discovery that they were distributing over $100,000 for every FTE job that was created was instrumental in their decision to restructure the program, as they concluded that there were more cost-effective avenues for economic development and job creation.

Subsidizing anything gets you more of that thing. The question is whether the benefits of a given amount of net new job creation and the net new investment exceed the cost. (I would note, however, that states must continuously increase the generosity of their programs or risk losing productions. It’s a never-ending escalation that no state can truly win, making it unlikely that any permanent industry will result from it.)

One measure of that is whether the tax credit pays for itself in induced tax revenue collections, or more than $1 generated for every $1 spent. Aside from Ernst & Young’s studies paid for by economic development authorities or the MPAA, every independent study has found film tax credits generate less than 30 cents for every $1 of spending (accounting even for movie-induced tourism, increased business to non-film businesses, and other indirect effects):

- **Arizona’s Department of Commerce** calculated 28 cents on the dollar.
- **Connecticut’s Department of Economic Development** found a 7 cent return on every $1 spent.
- **Two studies** in Louisiana found between 13 and 18 cents on the dollar.
- **Massachusetts’ Department of Revenue** found it got 16 cents on the dollar.
- **Michigan’s Senate Fiscal Agency** found 11 cents on the dollar.
- **New Mexico’s Legislative Finance Office** found 14 cents. (E&Y did **a New Mexico study** too, calculating $1.50 on the dollar, but having the same problems as their Michigan and New York studies.)
- **Pennsylvania’s Legislative Budget & Finance Committee** found 24 cents on the dollar.
Of the above studies, only Massachusetts’s study did not assume that all film and television production occurred because of the credit. All the other numbers should thus be considered on the high end.

**Conclusion**
Film tax credits do not pay for themselves. While some benefits accrue to in-state filmmakers and suppliers, on the whole they are a net transfer from taxpayers to out-of-state production company beneficiaries. The sheer magnitude of the amounts that various states are spending to lure productions makes it very difficult for any state to gain a lasting competitive edge over the others. Programs have steadily got more generous as states outbid each other, and it is telling that two of the most generous states (Michigan and New Mexico) recently greatly scaled back their programs. Other states continue to debate film tax credits’ merits.

At a minimum, film incentive programs should be required disclose credit amounts awarded by recipient, how much was spent per full-time equivalent (FTE) job was created, and reviewed periodically for their effectiveness by legislative oversight or independent third parties.

Again, thank you for the opportunity to testify. We are always available for questions or further testimony on this and other state tax policy matters.

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**TAX FOUNDATION**
Tax Foundation
National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045

202.464.6200
www.TaxFoundation.org

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