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2009–10 Budget Analysis Series

Film Production Credit

The film industry has always been centered in California. In recent years, however, concerns have been raised that high production costs are driving film production out of the state. In addition, other states and Canada offer subsidies for film production costs. The film industry in California is quite large. In 2007, for instance, employee compensation in the motion picture and sound recording industries totaled $14.6 billion.

The Governor's budget proposes substantial new personal and corporate income tax credits for the film industry. Specifically, the budget proposes:

- A 20 percent income tax credit for in–state production expenses of films with budgets below $75 million.
- A 25 percent credit in the case of an independent film (defined as a film with a budget of between $1 million and $10 million produced by a firm that is not publicly traded) or a television series returning to California from another state.

For a film to qualify as an in–state production, at least 75 percent of either the budget or the shooting days must be spent in California. Production expenses exclude wages paid to directors, producers, writers or actors (except extras). The total amount of credits available every year would be appropriated through the annual budget, and the state Film Commission would be required to approve qualified firms that apply for the credit on a first–come–first–served basis. The *2009–10 Budget Bill* does not include an appropriation for this purpose.

Proposal Has Multiple Problems. The intent of this proposal is to encourage film production to remain in California, or to return to or move to California from another state or country. The administration, however, has not provided a justification for the size of the subsidies being proposed or submitted an analysis of their likely impact on the film industry in California. Given the size of the state's film industry and the generous proposed subsidies, the new tax credit could prove very expensive. A 20 percent subsidy of the production expenses qualifying under this proposal would probably amount to over $1 billion per year. Since the state would be unlikely to appropriate that much for the program, the commission would have to allocate credits to specific productions. We have several major concerns with this proposal.

- One of the key issues in assessing any targeted business incentive program is: *Would the activity have taken place in the absence of the incentive?* If the incentive *was* in fact the deciding factor, the program would at least be accomplishing its stated goal (although there are other issues about whether the subsidies represent the best use of state money). However, if the activity would have taken place even without the incentive, then state subsidies represent a windfall for the firm that receives the incentive. The budget proposes to allocate credits on a first–come–first–serve basis. This would undercut the program's incentive for production companies to change their location decisions, as it seems likely that the firms who are absolutely committed to producing in California would be among the first to apply for credits—before firms that are considering an out–of–state location. As a result, this proposed credit may be even more likely than most similar programs to create a windfall for committed in–state producers rather than be a deciding factor for otherwise–undecided producers.
- Second, the program would likely create inequities in the way film companies are treated. Because claims would likely be much larger than available funding and the first–come–first–served targeting, some firms would be approved for credits while other equally qualified firms would be denied simply because they did not apply soon enough. This is an example of a "horizontal inequity," meaning that similarly situated taxpayers would be treated differently.
- Third, it is not clear that the film industry's situation is unique among industries that produce for a national or international market. If production costs for the film industry are higher here than in some other locations, it is also likely to be true for the electronics, finance, chemicals, and food processing industries. The administration has not made the case that the film industry deserves special treatment because it faces unique challenges that other sectors of the economy do not experience.

For these reasons, we recommend that the Legislature reject the film tax credit proposal. It would arbitrarily favor some film producers over others, and will mostly fund productions that would have been filmed in California in any case. We agree that the state's business climate is a crucial issue. Rather than singling out individual industries, however, the state should endeavor to create the conditions that permit all businesses to thrive.