The California Film & Television Tax Credit Program

The California Film & Television Tax Credit Program (Film Tax Credit Program or Program) was enacted in 2009 as part of an economic stimulus plan to promote production spending, jobs, and increased tax revenues in California. The main goal of the Film Tax Credit Program is to prevent so-called "runaway production" by retaining film production in California. Efforts to establish a film tax credit had been made prior to 2009, but the existing Program was initially recommended and signed into law by then Governor Schwarzenegger.

I. <u>Background and Description of the Film Tax Credit Program</u>

The Film Tax Credit Program was established in 2009 (AB X3 15, Krekorian, and SB X3 15, Calderon). The 2009 legislation authorized the California Film Commission (CFC) to allocate $100 million in credits annually beginning in FY 2009-10 and ending in FY 2013-14. Despite the $100 million annual cap, the legislation effectively allowed the CFC to allocate the first two fiscal years of tax credits (i.e., $200 million) in FY 2009-10, the third fiscal year of credits in FY 2010-11, and so on. At this rate, the $500 million aggregate cap was set to be reached during FY 2012-13. In 2011, however, the Legislature authorized an additional $100 million annually through FY 2014-15 (AB 1069, Fuentes). In 2012, the Legislature again extended the program for two additional years, authorizing $100 million annually through FY 2016-17 (AB 2026, Fuentes).

The Film Tax Credit Program provides qualified taxpayers a motion picture production tax credit, under either the Personal Income Tax Law or the Corporation Tax Law for qualified expenditures attributable to specified productions made in California. The Program requires the CFC to allocate the $100 million in credits each year on a first-come, first-served basis, with 10 percent of the allocation reserved for independent films. Independent films are those with a production budget of between $1 million and $10 million and produced by a company that is not publicly traded. The taxpayer may claim the credit directly, assign it to another member of their unitary group, or elect to apply the credit against their sales and use tax liability. Qualified expenditures include crew and staff salaries, rental costs for facilities and equipment, and production costs like construction, wardrobe, food, lodging, and lab processing. The Program requires that at least 75 percent of production days take place in California, or alternatively, that 75 percent of the production budget be incurred for payment of services performed within the state and for the purchase or rental of property used within the state. In addition, the Program requires that the production of the qualified motion picture be completed within 30 months of the date of the approved application.

The Film Tax Credit Program provides either a 20 percent tax credit for qualified expenditures attributable to the production of a qualified motion picture in California or a 25 percent tax credit for qualified expenditures attributable to an independent film or a television series relocating to California. The tax credits are nonrefundable and nontransferable, except in the case of certain independent productions, which are allowed to sell their tax credits. The tax credit is also limited to productions with budgets between $1 million and $75 million. The Program allows unused tax credits to be carried forward for six taxable years, or until the credit is exhausted, whichever occurs first.

II. **Purpose of the Film Tax Credit Program**

The main goal of the Film Tax Credit Program is to prevent runaway production by retaining production already taking place in California. According to the CFC, in 2003, 66 percent of studio feature films in the United States were filmed in California. In 2009, however, only 38 percent of studio films were filmed in state. (*California Film & Television Tax Credit Program Progress Report*, California Film Commission, Jan 2011). In San Francisco, for example, film and television production employment dropped 43 percent between 2001 and 2006. *Id*. This trend has continued, in part, due to other states offering lower costs, more readily-obtained incentives, and fewer regulatory obstacles to production.

States and foreign countries have been fiercely competing with California to lure motion picture and television series production away from California. Specifically, Canada introduced subsidies in 1998, which are credited with increasing film production in that country. (*Economic and Production Impacts of the 2009 California Film and Television Tax Credit*, UCLA Institute for Research on Labor and Employment, Nov 2011). Canada's film and television industry has been further enhanced through additional local incentives, labor savings, and a weaker Canadian dollar. Because of these incentives, Canada is now generally regarded as providing production services at a level comparable to Los Angeles and New York. *Id*.

Pressure to move production away from California has also come from other states. For example, Louisiana increased its film production from one film in 2002 to 54 films in 2007. *Id*. Louisiana enacted its film tax credit in 2002 at a time when the state's annual film production activity was between roughly $10 and $30 million. In 2004, after the credit's enactment, Louisiana's film production increased to $354 million. *Id*. Similar examples can be found in Massachusetts and New Mexico, with large increases in production occurring after the enactment of a film tax credit. *Id*. The success of some countries and states in luring production from California has prompted others to act. The number of states offering some sort of film production incentive program grew from 5 in 2002 to 44 in 2010. *Id*.

The "project-based" nature of film and television production is a major factor in allowing companies to easily pick up and move to other locations to take advantage of subsidies. *Id*. As an example of how sensitive film productions are to subsidies, the New York State Department of Taxation and Finance reported a dramatic decline in filming television pilots in 2009 when the state's film tax credit program ran out of money. Specifically, in 2009, the year the tax credits ran out, only four pilots were filmed in New York, 16 fewer pilots than the year before. In 2010, when funds were once again available for the film tax credit program, 22 pilots were filmed. *Id*.

III. Effectiveness of the Film Tax Credit Program

a. Arguments of Program Proponents

A report released by the Milken Institute states that, although "it is still too early to know the real impacts of the Film Tax Credit Program, there are some encouraging signs" that the Program is working. (K. Klowden, A. Chatterjee, and C. Flor Hynek, *Film Flight: Lost Production and Its Economic Impact on California*, Milken Institute, July 2010). Thus, in January of 2010, the Los Angeles Economic Development Commission (LAEDC) projected that, as a result of the California incentive program, production in the state would likely pick up in 2010. The projection by the LAEDC was bolstered by a report from Film L.A. (the permitting agency for Los Angeles). Film L.A. reported that, in 2010, feature film production posted a 28.1 percent fourth quarter gain and a year-over-year gain of 8.1 percent. In Film L.A.'s January 11, 2011 release, it was reported that the increase could be wholly attributed to the Film Tax Credit Program. The Program attracted dozens of new feature film projects to Los Angeles, and was responsible for 26 percent of the local feature production for the year. According to the CFC, these numbers are an early indicator that the 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, approximately $600 million in tax credits, including those conditionally allocated this year, has been allocated since the enactment of the Program. The total aggregate amount of direct spending is estimated to be $4.7 billion, of which an estimated $1.48 billion is attributable to qualified wages (excluding any wages for actors, directors, writers, and producers). Based on average aggregate spending by projects from each fiscal year, each $100 million of allocated tax credits will generate $792 million in direct production spending and cause productions to hire an estimated 8,500 cast and crew members. (CFC, Progress Report, July 2013).

Proponents also argue that California has a comparative advantage over other states because of its long established entertainment industry. This industry has provided California with a skilled workforce and ready infrastructure. It has been argued that this comparative advantage, when coupled with an incentive program, should 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. Arguments of Program Opponents

Despite the apparent success of increased film production and job growth, not everyone agrees with this use of state funds. Specifically, tax credits do not address the underlying issues (e.g., higher tax rates, regulatory impediments) that have led to California's sometimes challenging business climate. (San Jose Mercury News, *Hollywood tax break prompts debate over economy*, Tom Verdin, August 2012). Addressing these underlying issues, instead of allowing tax credits, may actually provide a more sustainable long term solution to the problem. In fact, according to a recent National Public Radio broadcast, "[s]tudies by think tanks across the political spectrum say states could get more bang for their buck with a general tax cut." (Julie Rose, *States Ponder Costs, Benefit of Film Incentives*, National Public Radio, Sept 2013). Additionally, having states compete against one another is an unsustainable downward spiral that may eventually cause California to spend more money than necessary to retain or lure production. As noted by the Tax Foundation, "subsidizing anything gets you more of that thing." The appropriate question, therefore, is not whether production is increased but "whether the benefits of a given amount of net new job creation and the net new investment exceed the cost." (*Important Questions to Ask in Evaluating a Film Tax Incentive Program*, Tax Foundation, March 2012).

Opponents have argued that subsidies to the film and television industry benefit production that would have occurred in the absence of the incentive and that "much of the subsidy represents a real loss of revenue with no net new jobs to offset the cost." (M. Robyn, Tax Foundation, *Film Production Incentives: a Game California Shouldn't Play*, p. 1, a report presented at the Joint Oversight Hearing of the Committee on Revenue and Taxation and the Committee on Arts, Entertainment, Sports, Tourism, and Internet Media, March 21, 2011). Furthermore, in its 2009-10 Budget Analysis Series, the LAO noted that the credit is allocated on a first-come first-served basis, which undercuts the Program's incentive for production companies to change their location decisions. The firms that 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," and as a result, the 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." (2009-10 Budget Analysis Series, Film Production Credit, February 5, 2009).

IV. Conclusion

California is in a unique position 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 industries continue 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.