



Film Tax Credit will be a loser for Ohio

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With the Ohio legislature in the final stages of deliberation on the state budget, policymakers are faced with a revenue decline of historic proportions. Tax revenues for Fiscal year 2010 are forecasted to fall \$3.5 billion below their 2008 level – a drop of 18 percent.¹ Even with a revenue loss of such magnitude that Ohioans face potentially crippling cuts in vital services, House Bill 1 – the budget legislation – includes new tax breaks that will lower revenue even further. Existing tax credits and exemptions are projected to cost the state approximately \$15 billion over the FY 2010-2011 budget biennium.²

One of the proposed new tax breaks is directed to the movie-making industry. Under a proposal included in H.B. 1, Ohio would join 41 other states that offer preferential tax treatment in the hope of luring film production to the state. The aim is not that someone in Cleveland or Chillicothe can see a snippet of their neighborhood on the big screen with a famous actor walking down the street. Supporters of these credits contend that the economic activity, and resulting tax revenue, that a movie production brings would far exceed the cost to the state of giving away tax breaks.

But these credits have become controversial in many states because the reality is that they do not work as advertised. The film industry generally does not create permanent jobs and imports much of its highly paid labor from out-of-state. The pressure for states to compete for film production has become extremely intense, leading to a bidding war. Michigan, for example, will pass out \$99 million in film tax credits this fiscal year and \$198 million next year.³

The bottom line is that they are a net loss to state treasuries even when the film industry grows. That, in turn, means that state services or programs must be cut – or taxes raised – to keep the budget in balance due to the loss from tax credits.

An analysis by the Federal Reserve Bank of Boston summarized the issue this way:

The little evidence available suggests that film tax credits do attract film production and create jobs in states that have little or no film industry. However, they also cost states considerable foregone tax revenue. The film production stimulates little additional economic activity in other industries.

Consequently, film tax credits do not “pay for themselves” by indirectly generating additional corporate income, sales, and property tax revenue.⁴ [emphasis added]

Given the state's fiscal condition and the actual impact of film credits, it is clear that Ohio would be better off without a film production tax credit. There are better, if less glamorous, uses for economic development resources that will have a more positive effect on growth far into the future – like workforce training and programs to help companies adopt new technologies.

Fiscal Effects of Film Tax Credits in Other States

All of Ohio's surrounding states have some form of film tax credit. A survey by the Associated Press found the 41 states with subsidies for the movie industry committed \$1 billion in 2008.⁵ Some states, particularly Louisiana and New Mexico, actually have boosted the presence of the movie industry within their borders, though not necessarily to their economic benefit. As more states adopt a credit their value to each state declines as the bidding for movies becomes more intense and film producers adeptly shop around for the best deal.⁶ New York, for example, recently felt compelled to triple its credit.⁷

Film production tax credits have been analyzed in several states. As Ohio Tax Commissioner Richard Levin, citing studies of New Mexico and Louisiana film tax credits testified to the Ohio legislature, “...the anticipated payback in terms of state tax revenues is only 14%-20% of the credit cost.”⁸ The summary of studies from other states follows:

Connecticut. The state Department of Economic and Community Development analyzed one year's worth of film productions and found new revenues only covered about 20 percent of the amount the tax credits.⁹ Connecticut Voices for Children, a non-profit group, this year reported a negative return on state investment, in part because Connecticut law allows products and services purchased out-of-state to be eligible for the credit.¹⁰ The Voices for Children's report estimated that the state might get back as little as four cents for each dollar of tax credit invested, and no more than 20 cents on the dollar if very generous assumptions were used.¹¹

Louisiana. A 2005 report by the Louisiana Legislative Fiscal Office found that while film production increased significantly in the state, revenue gains only offset about 16 to 18 percent of the costs of the credit.¹² The report noted that even if 100 percent of movie production purchases were made in-state, rather than 40 percent, the state would still only recover 35 to 40 percent of its costs.¹³

Massachusetts. The Massachusetts Department of Revenue analyzed the state's film production tax incentive applications over a three-year period (2006 to 2008) and estimated that the state would forego approximately \$138 million in tax revenue and collect \$18.6 million in income tax revenue from film productions.¹⁴ The report stopped short of drawing final conclusions about net total economic and tax impacts but noted that the analysis would have to

take into account lowered state spending as well as multiplier effects on the rest of the economy from spending by film production companies and their employees.

New Mexico. New Mexico State University, in a study conducted for the state Legislative Finance Committee, found that \$39.2 million in tax rebates given for film production in 2008 yielded just \$5.5 million in revenues – a recovery rate of 14 percent.¹⁵

Pennsylvania. The Pennsylvania legislature commissioned a study by Economics Research Associates, an economic consulting firm,¹⁶ which found that the state’s program created a net fiscal loss even if both state and local tax revenues are included.¹⁷ State and local governments were estimated to have gained back only 30.8 percent of the value of the tax credit.

Wisconsin. The Department of Commerce concluded that the Wisconsin film tax production tax breaks were not cost effective based on actual production costs and tax credit awards from the major motion picture “Public Enemies.”¹⁸ Of the \$18 million total production costs, \$5 million were spent in Wisconsin. The tax credit amount was \$4.6 million, almost completely subsidizing in-state expenditures. The estimated taxes paid by the production were \$270,000, recovering a paltry 5.9 percent of the original credit amount.¹⁹ The legislative Joint Committee Finance proposed incorporating changes to the credit in the state’s budget bill and limiting new credits to \$1.5 million per year over the next two years.²⁰

Advocates for film tax credits often cite reports showing the benefits of such programs. But some have been shown to be flawed, as was the case with two studies by Ernst & Young (E&Y) dealing with New Mexico and New York.²¹ Both studies were sponsored by the film offices of the respective states. A critique by Jennifer Weiner, of the Federal Reserve Bank of Boston,²² found:

Although some of the methodological choices made by the E&Y authors are legitimate, there are several problems with the studies that lead us to question the accuracy their findings. For example neither E&Y study incorporates a balanced budget requirement (though both states have one), and neither adjusts for salaries earned by big name actors and other ‘above the line’ personnel who are likely to reside out of state. Furthermore, both E&Y studies lack explanatory methodological detail, which makes it difficult to gauge whether their findings are plausible.²³

Weiner also noted that these studies assumed that all of the production activity receiving credits would not have occurred in the absence of a credit, and that between 25 and 40 percent of the economic gains from the film tax credit occurred because of increased *tourism* after production was finished. The chief economist of the New Mexico Legislative Finance Committee also raised concerns about the methodology of the Ernst & Young study, writing in a memo to legislators that the study had “...overstated the case for the fiscal impact of the film production tax credit.”²⁴

The consensus among independent studies of the fiscal returns to film production tax credits is that these subsidies are net *losers* for state treasuries, even in states where the level of film production increased significantly. The economic returns to a state are better to the extent that more purchases take place in-state and more state residents are hired. Economic effects are permanent only under certain conditions, such as investments in studios and production facilities, development of a specialized labor pool, or significantly increased tourism. As other states' credit programs become more generous, Ohio's price of admission to this competition is increasing. This raises the question of whether it is a price worth paying – especially when the tradeoff is cuts in state funds available for education, health, and existing economic development programs. The weight of the evidence is that the state would be better off not going down this path.

Analysis of Current Ohio Legislation

As H.B. 1 made its way through the General Assembly it became more favorable to the film industry.²⁵ By the time the bill went through the Senate, the film tax credit had been radically altered in crucial ways. The legislative conference committee now has the task of reconciling the House and Senate versions of the bill. The conference committee can choose to adopt either version, delete it entirely, or modify the program to make it acceptable to both chambers.

The original executive proposal would allow the Department of Development to issue up to \$20 million in "refundable" tax credits to motion picture production companies over the budget biennium.²⁶ A refundable credit means that the film production company or its investors would receive a payment for any amount of the credit remaining after tax liability is reduced to zero. Both movie and television productions would be eligible for reimbursement, with a long list of exclusions intended to disqualify shorter productions that did not use many actors or crew members.²⁷ The minimum investment threshold to receive a credit would be \$1.2 million with the actual amount of the credit limited to 25 percent of the original budgeted Ohio expenditures or actual expenditures, whichever was less.

The executive proposal listed items and services that would count toward the credit and would have to be purchased and consumed in Ohio. Most importantly, the proposal promoted the hiring of Ohio residents by limiting non-resident payroll expenses to no more than 10 percent of the total amount claimed in the application for the credit.²⁸

The House version of the bill lowered the minimum investment amount to \$300,000. Instead of maintaining the cap on claiming non-resident payroll expenses, the House added a higher 35 percent credit for Ohio residents' payroll. Reimbursement for all other expenditures remained at 25 percent.

The Senate version of the bill is a reprise of House Bill 196 from the previous legislative session. Richard Levin, the Ohio Tax Commissioner testified against the bill in both the House and Senate. His testimony raised three main objections to the bill.²⁹

1. The revenue the state would lose was unacceptably high, even accounting for an expected increase in economic activity.
2. Economic analyses in other states have shown that the credits do not pay for themselves.
3. The bill created a “bad precedent” by making the tax credit transferable to others not involved in film production.

Despite the administration’s objections, the General Assembly passed House Bill 196 in December 2008; the governor vetoed it in January with a message that repeated the Tax Department’s objections and added that the matter should be dealt with in the budget.³⁰

The reprise of H.B. 196 in the Senate version of the budget would allow \$100 million in tax credits to be issued each year through 2013. This represents an enormous investment. By way of comparison, the state has issued \$50 million in bonds annually to finance the Third Frontier program, its premiere investment in science and technology. The state had also planned to invest \$50 million per year in an internship and coop program that will now likely be put on hold because of the budget crunch.

The Senate version has no preferences for hiring Ohio residents. The credit is not refundable, but becomes transferable to any other taxpayer and can be carried forward for up to 10 years until it is used up. Taxpayers who purchase the credit do not need to have any relationship to the original film production activity.

For an investment of \$300,000 or more, the credit is 25 percent of the investment amount. Unlike in the executive or House proposal, goods purchased outside of Ohio are eligible for the credit.

As the Tax Commissioner noted last year, one of the most troubling provisions of the version passed by the Senate in H.B. 1 is that it allows the credit to be granted based on estimated production expenses before the movie is complete. Since estimated costs could be higher than actual costs, the amount of the credit could exceed the investment amount.³¹ Under the bill, the state gives up its recourse to recover disallowed amounts from the owner of the tax credit certificate, which may be sold to a third party. Instead, the state can seek compensation from an affiliate of the movie production company that has been previously named for this purpose. This method for adjusting previously-issued credits is likely to lead to litigation. The entire situation could be avoided if the credit is issued after production is complete, based on audited financial statements.

Conclusion

When the governor vetoed last year's tax credit bill (H.B. 196) his message was that the issue should be taken up in the context of the budget debate. Since his veto in January, the state's fiscal condition has deteriorated to the point that the conference committee is faced with the prospect of cutting an additional \$3.2 billion from the budget unless it takes action to raise revenue. These cuts will reduce or eliminate vital health and human services programs at a time when Ohio families need them the most. There could not be a worse time to create a subsidy that will open another hole in the state budget. A host of studies from other states have shown that film tax credits do not "pay for themselves." Because the state must balance its budget, the revenue lost from a film tax credit will have to be balanced through cuts to state spending that will reduce jobs and economic activity. The cost of admission to the bidding war for film production is very high and getting higher. There are other economic development strategies that are more likely to create permanent jobs and build a comparative advantage for the state. The film tax credit should be removed from House Bill 1.

¹ Author's calculation based on the "Revised GRF Tax Estimates" table, page 10 of the Testimony of J. Pari Sabety, Director, Office of Budget and Management, to the Conference Committee, June 11, 2009. Provided by Gongwer News Service.

² The Ohio Department of Taxation publishes a list of these exemptions and credits, known as "tax expenditures," in the executive budget, available at <http://obm.ohio.gov/SectionPages/Budget/FY1011/ExecutiveBudget.aspx>. For an independent review of this document, see Zach Schiller, *Spending by Another Name: The 2009 Tax Expenditure Report*. Policy Matters Ohio. June 2009. Available at <http://www.policymattersohio.org/OhioTaxExpenditures2009.htm>.

³ Suzette Hackey, "Michigan Lawmakers Propose Lower Film Tax Credits," *State Tax Notes*. March 31, 2009. Tax Analysts new service, 2009 STT 59-17. For a list of film tax credits in major states, see Wisconsin Legislative Fiscal Bureau report, *Film Production Tax Credits Program Changes*, Joint Committee on Finance, Paper #251, April 30, 2009, "Table 1: Film Tax Credits," pp. 8-11, Available at <http://www.legis.state.wi.us/lfb/2009-1Budget/Budget%20Papers/251.pdf>.

⁴ Darcy Rollins Saas, "Hollywood East: Film Tax Credits in New England," New England Public Policy Center at the Federal Reserve Bank of Boston. Policy Brief 06-3 (October 2006), p. 1.

⁵ Waggoner, Martha. "States Give Hollywood a Fortune in Tax Breaks." The Associated Press. June 2, 2009. Available at <http://www.ctkidslink.org/publications/bud09apfilmtax.pdf> (Connecticut Voices for Children)

⁶ *Id.* California lost the film "Terminator Salvation" to New Mexico, while North Carolina lost a new Disney production to Georgia.

⁷ "Governor Paterson signs bill expanding tax credit for New York State film productions," press release, Office of Governor David Paterson, April 23, 2008. Available at http://www.state.ny.us/governor/press/press-043081_print.html.

⁸ Testimony of Tax Commissioner Richard A. Levin, House Bill 196, Senate Ways and Means and Economic Development Committee, December 10, 2008, p. 1.

⁹ Stanley McMillen, "Connecticut's Film Tax Credit: Blockbuster or Budget Buster?" in *The Connecticut Economy*. A *University of Connecticut Quarterly Review*. (Summer 2008). Summarizes the results of the DECD report. Available at http://cteconomy.uconn.edu/TCE_Issues/Summer_2008.pdf. Jennifer Weiner, "Cost-Benefit Analysis of Connecticut's film tax credit," Memorandum to Ellen Scalettar, Director of Policy, Research & Legislation for the Connecticut Senate Democrats, January 19, 2009. New England Public Policy Center, Federal Reserve Bank of Boston, p. 1-2. Available at <http://www.bos.frb.org/economic/neppc/>

¹⁰ Shelley Geballe, *Fiddling While Rome Burns: Connecticut's Multi-Million Dollar, Money-Losing Subsidy to the Entertainment Industry*. Connecticut Voices for Children. June 2009. Available at www.ctkidslink.org/publications/bud09filmtax.pdf.

¹¹ *Id.*, p. 7.

¹² Albrecht, Greg. State of Louisiana. Legislative Fiscal Office. "Film and Video Tax Incentives: Estimated Economic and Fiscal Impacts." March 2005, p. 3. Available at <http://lfo.louisiana.gov/files/revenue/FilmVideoIncentives.pdf>

¹³ *Id.*, p. 4.

¹⁴ Navjeet K. Bal. *A Report on the Massachusetts Film Industry Tax Incentives*. Commonwealth of Massachusetts Department of Revenue. March 2008., pp. 5-6. Available at http://www.mass.gov/Ador/docs/dor/business/outstate/March_2008_Film%20_Incentives.pdf.

¹⁵ Anthony V. Popp and James Peach, "The Film Industry in New Mexico and the Provision of Tax Incentives," Arrowhead Center, Office of Public Policy Analysis, New Mexico State University. A report submitted to the Legislative Finance Committee of the State of New Mexico. August 26, 2008.

¹⁶ Economics Research Associates, "Pennsylvania's Film Production Tax Credit and Industry Analysis," (May 2009) ERA Project number 18238. Published by the Legislative Budget and Finance Committee, Pennsylvania General Assembly. Conducted Pursuant to Senate Resolution 2009-20 and House Resolution 2009-127 (May 2009). Available at <http://lbfc.legis.state.pa.us>

¹⁷ *Id.*, Table 20, "Net Present Value of FY 2007-2008 Projected Impacts," p. 54. Based on a net present value of \$58.2 in film tax credits and a \$17.9 million increase in tax and fees collection by state and local governments.

¹⁸ The study is not available on the web but is summarized by a Wisconsin Legislative Fiscal Bureau report, "Film Production Tax Credits Program Changes," Joint Committee on Finance, Paper #251, April 30, 2009, pp. 14-16.

¹⁹ Percentage calculation by the author. The department did not use dynamic analysis but even a multiplier effect of two or three times the original production spending would still only allow the state to recover 12 to 18 percent of its investment.

²⁰ Wisconsin Legislative Fiscal Bureau. Memorandum from Bob Lang, Director, to Members of the General Assembly. "State Tax and Fee Modifications Included in the Joint Committee on Finance's version of the 2009-11 Budget." June 9, 2009, p. 5. Available at <http://www.legis.state.wi.us/lfb/2009-11Budget/Budget%20Papers/251.pdf>

²¹ Ernst & Young. *Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit*. Prepared for the New Mexico State Film Office and State Investment Council. January 2009. Available at <http://www.nmfilm.com/locals/downloads/nmfilmCreditImpactAnalysis.pdf>; and *Economic and Fiscal Impacts of the New York State Film Credit*. February 2009. Prepared for the New York State Governors Office of Motion Picture and Television Development and the Motion Picture Association of America. Available at http://www.southwindsor.org/pages/swindsorct_IT/New%20York%20Ernst%20&%20Young%20State%20Film%20Credit%20Study.pdf

²² Jennifer Weiner, "Ernst & Young Analyses of New Mexico and New York Film Tax Credits," Memorandum to Shelley Gabelle, Distinguished Senior Fellow, Connecticut Voices for Children. April 2, 2009. New England Public Policy Center, Federal Reserve Bank of Boston. Available at <http://www.bos.frb.org/economic/neppc>

²³ *Id.*, p. 1.

²⁴ Memorandum from Norton Francis, Chief Economist, State of New Mexico Legislative Finance Committee, to Senator John Arthur Smith, Chair SFC and Representative Luciano "Lucky" Varela, Vice-Chair HAFC, Re: Ernst & Young Film Study – Revised. March 7, 2009, p. 1. Available at <http://legis.state.nm.us/lcs/lfc/lfcdocs/LFC%20Analysis%20of%20Ernst%20&%20Young%20Film%20Study%20-%20February%202009.pdf>

²⁵ The Legislative Service Commission Comparison document provides a summary of the fiscal provisions. Available at <http://www.lbo.state.oh.us/fiscal/budget/comparedoc128/default.cfm>.

²⁶ See Legislative Service Commission, "Bill Analysis, Sub. H.B. 1, 128th General Assembly" (As Introduced--LSC 128 0516-2), "Movie and television production tax credit," pp. 473-476. This document and the text of the bill itself are available at www.legislature.state.oh.us

²⁷ Motion pictures eligible for the credit include feature films and documentaries, TV series and specials, but not news, weather, sports, or financial market reports, award shows, fundraising, or obscene materials. Revised Code section 122.85(A)(5) in Sub. H.B 1, As Introduced, (First Substitute Bill – LSC 128 0516-2).

²⁸ R.C. section 122.85(A)(4) definition of "eligible production expenditures" in H.B. 1 As Introduced (First Substitute – LSC 128 056-2).

²⁹ Testimony of Tax Commissioner Richard Levin, House Bill 196 (Patton), House Ways and Means Committee, November 19, 2008 and for the Senate Ways and Means and Economic Development Committee, December 10, 2008.

³⁰ Governor Strickland's veto message for bills vetoed January 6, 2008, obtained through Gongwer News Service.

³¹ See Legislative Service Commission, "Final Analysis, Sub. H.B. 196, 127th General Assembly," page 6.