

THERE'S NO BUSINESS LIKE THE STATE FILM TAX INCENTIVE BUSINESS: AN ANALYSIS OF PENNSYLVANIA'S FILM PRODUCTION TAX CREDIT PROGRAM

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Volume XIII – Fall 2012

Bat mobiles racing down Grant Street,² fans filling Heinz Stadium bundled in black and yellow in the middle of the summer,³ and celebrity sightings⁴ in local restaurants can cause excitement in the Pittsburgh metropolis. The Steel City is just one of many areas in Pennsylvania that has seen a surge of film production in recent years, causing buzz that a permanent film industry and consequently, economic growth is on the horizon. With the approval voting of tax rates on June 30, 2012, Pennsylvania legislators elected to allot \$60 million to the Pennsylvania Film Production Tax Credit Program.⁵ While the new budget allots the same amount in tax credits as last year, the program has been passed on a multi-year basis until the 2015-2016 fiscal year, introducing the possibility of filming television series for the first time.⁶ With the renewal of the film tax credit system, some speculate whether the benefits postured by its proponents, namely the creation of a new self-sustaining statewide industry,

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² Harry Lay, *Batmobile Spotted in Pittsburgh While Filming "The Dark Knight Rises"*, AUTOGUIDE.COM (Aug. 4, 2012, 3:30 PM), <http://www.autoguide.com/auto-news/2011/08/batmobile-spotted-in-pittsburgh-while-filming-the-dark-knight-rises-video.html>.

³ Ben Kendrick, *'Dark Knight Rises' Heinz Field Shoot Details and Images*, SCREENRANT, <http://screenrant.com/dark-knight-rises-heinz-field-shoot-details-images-ben-127105/> (last visited Nov. 17, 2012).

⁴ Jessica Sinichak, *News Nearby: Channing Tatum Filming 'Foxcatcher' in Connoquenessing*, NORTH HILLS PATCH (Nov. 16, 2012), <http://northhills.patch.com/articles/news-nearby-channing-tatum-filming-foxcatcher-in-connoquenessing>.

⁵ Tim Schooley, *Film Tax Credit Multilayer Commitment May Draw More TV Series to Pittsburgh Region*, PITTSBURGH BUS. TIMES, July 6, 2012, <http://www.bizjournals.com/pittsburgh/print-edition/2012/07/06/film-tax-credit-multiyear-commitment-pgh.html?page=all>.

⁶ Schooley, *supra* note 5; Timothy McNulty, *Changes in Pennsylvania's Film, Television Tax Credit Worry Some in Industry*, PITTSBURGH POST-GAZETTE, July 8, 2012, <http://www.post-gazette.com/stories/local/state/changes-in-pennsylvanias-film-television-tax-credit-worry-some-in-industry-643800/>.

increases in the total tax revenue for the state, and stimulating economic activity are in fact a reality.

This article will provide an overview of the Pennsylvania film tax credit program and question whether the perceived benefits of film tax credits are in fact a reality, and whether the legislature should continue to support the program.

THE NATIONAL EXPLOSION OF STATE FILM TAX INCENTIVES

State film tax incentives have exploded in popularity in the last decade. As television and film industries grew through the 1990s, so did the concern over “runaway productions,” television shows and films that are intended for a United States audience but are filmed in other countries in order to reduce production costs.⁷ The issue of runaway productions heightened after Canada adopted a movie production incentive program in 1997,⁸ sparking an interest in U.S. states to introduce their own incentive programs in the hopes of getting a piece of the Tinseltown pie. In 2000, only four states offered subsidies.⁹ Today, forty-five states and Puerto Rico offer film incentives including tax credits, rebates, and exemptions.¹⁰

THE PENNSYLVANIA FILM PRODUCTION TAX CREDIT PROGRAM

The Pennsylvania Film Production Tax Credit (FTC) Program is classified as an economic development tool, which is used to cultivate and develop the film industry in

⁷ Adrian McDonald, *Down the Rabbit Hole: The Madness of State Film Incentives as a “Solution” to Runaway Production*, 14 U. PA. J. BUS. L. 85, 109 (2011).

⁸ CANADA FILM CAPITAL, <http://www.canadafilmcapital.com/> (last visited Nov. 22, 2012).

⁹ Zach Huitink, *Is it a Wrap for Movie Subsidies?*, 72 CAPITOL IDEAS 3 (2012), available at http://www.csg.org/pubs/capitolideas/enews/issue72_3.aspx.

¹⁰ *State Film Production Incentives and Programs*, NAT’L CONFERENCE OF STATE LEGISLATURES (Jan. 2011), <http://www.ncsl.org/issues-research/budget/state-film-production-incentives-and-programs.aspx> (states without film incentives are: Delaware, Nebraska, Nevada, New Hampshire and South Dakota).

Pennsylvania.¹¹ The initial program, authorized under Act 55 of 2007, provided a tax credit equal to twenty-five percent of a film production's "qualified Pennsylvania production expenses" for film productions where at least sixty percent of the total production budget is spent in Pennsylvania.¹² In its first year, the program cost \$75 million, \$42 million in the 2009-2010 fiscal year, and \$60 million in the 2010-2011 fiscal year.¹³

On June 30, 2012, legislators approved another \$60 million for film tax credits after voting on state tax rates, and increased the credit up to thirty percent for those filming at soundstage facilities in Pennsylvania that have at least 7,500 square feet of clear production space.¹⁴ They also approved the credits to be granted over multiple years, allowing the credits to be issued to television series for the first time.¹⁵ Prior to this change, "only one-off television productions, such as reality shows and cooking shows, have been eligible for the credits."¹⁶

In order to participate in the tax credit program, filmmakers complete and submit an application package to the Pennsylvania Film Office. Upon review, they are preapproved for a certain amount of tax credits. Once production begins, filmmakers are required to report to the Pennsylvania Film Office at the end of each month and upon the completion of the production, filmmakers are mandated to submit a series of reports.¹⁷ The film tax credits may then be

¹¹ *Report to the General Assembly on the Film Production Tax Credit Program FY 2011-12*, PA. DEPT. OF CMTY. AND ECON. DEV. (Sept. 1, 2012), http://filminpa.com/wp-content/uploads/2012/08/FY_2011-12_Report_to_Legislature.pdf [hereinafter *Report to the General Assembly*].

¹² S. BILL NO. 97, 2007 Leg. (Pa. 2007),

<http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=PDF&sessYr=2007&sessInd=0&billBody=S&billTyp=B&billNbr=0097&pn=1275>. See also, *Film Tax Credit Program*, PA DEP'T OF CMTY. & ECON. DEV., <http://www.newpa.com/find-and-apply-for-funding/funding-and-program-finder/film-tax-credit-program> (last modified Oct. 31, 2012).

¹³ Giles Howard, *Film Tax Credit Loss For All Involved*, THE PUBLIUS FOUNDATION (June 26, 2010), <http://www.publiusfoundation.com/2010/06/film-tax-credit-a-loss-for-all-involved/>.

¹⁴ McNulty, *supra* note 6.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Pa. Film Office, *Incentives*, FILMINPA, <http://filminpa.com/incentives/> (last visited Nov. 22, 2012) (final reports include: Production and Economic Impact Report, Pennsylvania Vendor/Subcontractor Report, Budget Sheet, Cast

applied against tax liability under several Pennsylvania taxes including personal income tax, corporate net income tax, and the capital stock and franchise tax.¹⁸

Notably, the FTC is a transferable tax credit, meaning that film production companies can either apply their film production tax credits to any Pennsylvania taxes they owe, or they may sell or assign the tax credits to one or more third-party Pennsylvanian taxpayers (including wealthy individuals and companies).¹⁹

The proponents of the FTC program argue that the program creates positive publicity and boosts tourism.²⁰ Furthermore, it is argued that the renewal of the tax credit program assures the growth of a new and sustainable industry, and creates jobs. The most popular argument for the FTC is that the program increases total tax revenue for the state.²¹ Skeptics of the FTC's merits claim the exact opposite: the program does not stimulate the local economic activity and employment nor does it create a profitable and a sustainable new industry in Pennsylvania.²²

While it is tempting to say that Pennsylvania can and should try to create economic diversity by developing and supporting a film industry until it can sustain itself without a tax credit program, a closer examination of the policy reveals three major problems: (1) it is difficult to predict the production's actions if no tax incentive was available, (2) the race against other state's incentive programs to attract productions creates a never-ending battle, and (3) reports are

and Crew Form, and a Project Audit for projects in receipt of film tax credits \$100,000 or greater or a Report on Agreed Upon Procedures for projects with tax credit less than \$100,000).

¹⁸ *Id.*

¹⁹ McDonald, *supra* note 7, at 109.

²⁰ Christopher Breakwell, *The Film Tax Credit Works, and Western Pennsylvania is a Winner*, PITTSBURGH POST-GAZETTE, Apr. 10, 2012, <http://www.post-gazette.com/stories/opinion/perspectives/the-film-tax-credit-works-and-western-pennsylvania-is-a-winner-630732/>.

²¹ *Id.* (“Since the program's inception, nearly \$242.5 million in state tax credits have been approved and/or awarded to film production companies, which has resulted in estimated total economic activity of \$1.8 billion and the creation and sustaining of almost 14,500 jobs statewide.”).

²² Howard, *supra* note 13.

finding that the program generates a net loss of tax revenue for the state, and does not create the purported numbers of jobs.

THE “BUT-FOR” PROBLEM AND TRANSFERRABLE CREDITS

For some productions, Pennsylvania is the most attractive filming location, with or without the tax credits. Its urban, suburban, and rural landscapes, coupled with four distinctive seasons, make Pennsylvania an ideal location for a variety of films even without the tax credit incentive.²³ Thus, any tax credits for these productions are a waste. This problem has been referred to as the “but-for” problem: it is not possible to know what each production would have done but for the incentive.²⁴

The collected data regarding the use of tax credits from the FTC may suggest that a majority of productions would have chosen Pennsylvania regardless of the tax credits. As mentioned, with transferrable tax credit, the production company may sell its remaining tax credits to other Pennsylvania taxpayers.²⁵ In the 2011-2012 fiscal year, sixty-eight production companies sold, transferred or redeemed film production tax credit certificates with a total worth of \$65.7 million.²⁶ Ninety-eight percent, or \$64.3 million in tax credits were either sold or transferred to another entity, with just \$1.4 million used by the initial tax credit recipient to reduce its Pennsylvania tax liability.²⁷

What is so telling about these figures is that local media and lobbyists in favor of the FTC program will name prospective blockbusters and claim Pennsylvania *must* keep its tax credit

²³ David A. Dunkle, *Pa. Towns Draw Film Projects, But Generate Film Tax Credit Program Critics*, PATRIOT-NEWS, Nov. 26, 2011, http://www.pennlive.com/midstate/index.ssf/2011/11/cinematic_state.html.

²⁴ Mark Robyn & Harry David, *Movie Production Incentives in the Last Frontier*, 199 TAX FOUND. 1 (2012), available at <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr199.pdf>.

²⁵ McDonald, *supra* note 7, at 109.

²⁶ *Report to the General Assembly*, *supra* note 11, at 11.

²⁷ *Id.*

program so that these major films will not leave and take advantage of another state's tax incentives.²⁸ In reality, major films, such as *The Dark Knight Rises* and *Transformers: Revenge of the Fallen*, were shot in Pennsylvania without the tax credits.²⁹ For other major films that did qualify and receive tax credits, such as *Unstoppable*, *Abduction*, or *Limitless*, most sold or transferred either all or the vast majority of their tax credits.³⁰

Moreover, the tax credits are allocated to productions that have long been producing in Pennsylvania, even in the absence of any tax incentives. QVC, the home shopping network, Rotfeld Productions, and Center City Video are all headquartered in Pennsylvania and they have received tax incentives since 2008, claiming over \$5.2 million, \$1.1 million, and \$1.9 million, respectively.³¹ If the main argument by the proponents of the FTC is that it attracts *new* productions, then granting tax credits to productions, such as QVC, Rotfeld Productions, and Center City Video, appears to be wasteful and stands in direct contrast to the claims made by the supporters of the FTC program.

Finally, not only do transferrable tax credits confirm that the productions that would attract tourism and publicity to Pennsylvania would come regardless of the tax credits, as shown by the overwhelming amount of tax credits that go unused and are transferred to third parties, but they bring into light another unsavory fact. Transferrable credits are profitable for filmmakers because they can sell such credits to other companies that owe taxes to Pennsylvania, regardless

²⁸ Fiore Mastracci, *Film Office Plays Crying Game for Republican Governor*, EXAMINER (Mar. 5, 2011), <http://www.examiner.com/article/film-office-plays-crying-game-for-republican-governor> ("Now as Governor Corbett begins to rim the blotted state budget, the Pittsburgh Film Office is crying *The Dark Knight Rises* will leave Pittsburgh if it can't offer...the tax credit incentive.").

²⁹ Dunkle, *supra* note 23.

³⁰ *Report to the General Assembly, supra* note 11, at 12 (*Unstoppable*: Used \$1,383,096 of tax credit/Sold or Transferred: \$16,399,596; *Abduction*: Used: \$0/Sold or Transferred: \$8,226,091; *Limitless*: Used: \$6,465/ Sold or Transferred: \$4,711,546).

³¹ *Film Incentives 101: Tax Credits=Cash, Not Lower Taxes for Production Companies*, RUNAWAY PRODUCTIONS RESEARCH (Mar. 16, 2012), <http://www.stop-runaway-production.com/2012/03/16/film-incentives-101-tax-credits-cash-not-lower-taxes-for-production-companiess/>.

of their line of business.³² The recipients of these transferrable tax credits consist of wealthy individuals, financial institutions, and large insurance companies that can use the credits to reduce their taxes on premiums.³³

The analysis of the unused and transferred tax credits suggests that when producers receive tax credits for films that they would produce in Pennsylvania absent the incentive, the credits do little but transfer wealth from the taxpayer to production companies or worse, to affluent third-parties.

FUTILE COMPETITION BETWEEN STATES AND LEGISLATURE'S ECONOMIC INEPTNESS

Tax incentives have also become a basis of competition among the states because of a “race to the lowest bidder at almost any cost to the state in the name of sparking economic development.”³⁴ In some states, film tax incentives have been extremely effective at attracting and retaining productions, thus sparking sister states to not only enact a film tax incentive program of its own, but to outdo other states. Advocates of Pennsylvania’s FTC program argue that if Pennsylvania does not offer its FTC program, it will have no leverage in attracting productions, thus it must continue to expand and increase its tax credits.³⁵

This race to the bottom is misguided and does not account for several factors. First, with forty-four states now offering competitive incentives, the market is oversaturated.³⁶ Second, it effectively holds Pennsylvania at the mercy of other states’ policies by explicitly engaging in an arms race of tax incentives. In this battle to outdo the other states, multiple states have already

³² McDonald, *supra* note 7, at 110.

³³ *Id.*

³⁴ Joshua R. Schonauer, *Star Billing? Recasting State Tax Incentives for the "Hollywood" Machine*, 71 OHIO ST. L.J. 381, 387 (2010).

³⁵ Breakwell, *supra* note 20.

³⁶ McDonald, *supra* note 7, at 114.

increased their subsidies from \$4 million in 1999 to \$1.4 billion in 2010.³⁷ Third, the number of films that get released each year is finite and, in fact, is steadily declining.³⁸

Along with the decline of the number of films produced each year, some economists and academics are starting to question the “sure bet” of investing in the film industry.³⁹ The increasing accessibility of television and film via affordable cable television and the Internet gradually displacing cable television represents an ease of access to film and television which was never known before during a time of economic adversity.⁴⁰ This increasing reality has been taken into serious consideration by several state legislatures, both those with existing tax incentives and those that have not yet adopted any kind of film industry incentive.⁴¹

In conjunction with the arms race between the states is the oddity of lawmakers acting as economists. In creating the FTC program, the Pennsylvania legislature boasts that it can competently anticipate which industries will thrive. Unfortunately, economists generally agree that “lawmakers have little to no success at creating a business cluster where one does not already exist.”⁴² If anything, the fact that film production is becoming more dispersed and more mobile, with Hollywood struggling to maintain its status as the center of the film industry, should be a major indication that Pennsylvania has a long way to go before it reaches the status of becoming a major center for the film industry.⁴³

³⁷ Robyn & David, *supra* note 24, at 3.

³⁸ McDonald, *supra* note 7, at 114.

³⁹ Schonauer, *supra* note 34, at 406-07.

⁴⁰ *Id.* at 407.

⁴¹ *Id.* at 409.

⁴² Robyn & David, *supra* note 24, at 4.

⁴³ *Id.*

Moreover, Pennsylvania's election to continue its FTC program fails to compare the FTC program's benefits with the advantages of applying similar tax incentives to another industry.⁴⁴ Policymakers need to be informed of the benefits of giving similar tax credits to another industry. In fact, a report issued by the Economics Research Associates (ERA) in 2009 listed "cheese, handtools, milk and butter, leather and hide tanning and fishing, and poultry industries as those that have higher multiplier effects than the film industry in Pennsylvania."⁴⁵ Thus, every dollar spent in any of these industries would produce more spending than a dollar spent in the film industry.⁴⁶

Pennsylvania's legislators should not lose sight of the future of the film industry as a whole when determining if the interests of the Pennsylvania taxpayers will be met by trying to establish this new industry, the same idea that forty-five other states have as well. Moreover, Pennsylvania should not be fooled into thinking that other states will not continue to try to outbid Pennsylvania's incentives.⁴⁷ Pennsylvania must recognize that this type of antagonism is economically harmful to the state, and while big productions can bring large sums of money into its local economy, policymakers are obligated to explore uses of state funds which may provide greater and more consistent returns.⁴⁸

THE REAL COST OF PENNSYLVANIA'S FILM TAX CREDITS

Arguably, the largest problem with Pennsylvania's FTC program is the lack of transparency and impartial analysis of the actual costs of the program. In its 2012 report to the

⁴⁴ Pavel Yakovlev & Anthony Davies, *Pennsylvania's Flawed Film Tax Credit: What the ERA Study Won't Tell You*, 21 POLICY BRIEF FROM THE COMMONWEALTH FOUND. 4 (2009), available at http://www.commonwealthfoundation.org/docLib/20090904_FilmTaxCredit.pdf.

⁴⁵ *Id.* at 4.

⁴⁶ *Id.* at 2.

⁴⁷ Robyn & David, *supra* note 24, at 3.

⁴⁸ Alexander Malyshev, *Financing Film Through Aggressive Tax Incentives - A Losing Proposition for the States?*, 19 FALL MEDIA L. & POL'Y 229, at 236-37 (2010).

Pennsylvania General Assembly on the Film Production Tax Credit Program, the Department of Community and Economic Development stated:

Since the program's inception, nearly \$300 million in state tax credits have been approved/awarded to film production companies over the past five fiscal years. These companies, in turn, have directly injected well over \$1.4 billion into Pennsylvania's economy, generated an estimated \$2.7 billion in total economic activity, and supported nearly 18,000 jobs.⁴⁹

As a starting point, in order to justify the FTC, its advocates would have to show that the price of the tax credits in terms of the lost revenue is lower than the benefit received. However, even the most favorable accounting of the FTC admits that the program results in a net loss of tax revenue for Pennsylvania.⁵⁰ But how is this possible when the production companies have "directly injected well over \$1.4 billion into Pennsylvania's economy"?⁵¹ The problem is that the film industry and some state film offices have carried out or contracted biased studies, finding that film tax credits are highly cost-effective drivers of economic activity.⁵² Conversely, the most impartial and cautious studies find just the opposite.⁵³ Additionally, a large hurdle in assessing the costs of the FTC is the confusion between public and private costs, and the benefits of the credits. Statements in the media concerning the benefits of the FTC program typically stress the increases in private sector activity (restaurants, hotels, etc.) and measure them against the public sector cost, often without mentioning the consequent lowering of other public expenses to offset the lost revenue from the credit.⁵⁴

⁴⁹ *Report to the General Assembly*, *supra* note 11, at 2.

⁵⁰ Howard, *supra* note 13 (referring to the 2009 report by the ERA, which can be accessed at <http://lbfc.legis.state.pa.us/reports/2009/35.PDF>).

⁵¹ *Report to the General Assembly*, *supra* note 11, at 2.

⁵² Robert Tannenwald, *State Film Subsidies: Not Much Bang For Too Many Bucks*, CENTER ON BUDGET & POL'Y PRIORITIES (Dec. 9, 2010), <http://www.cbpp.org/cms/index.cfm?fa=view&id=3326>.

⁵³ *Id.* Tannenwald studied ten independently prepared economic reports, including Pennsylvania, eight of which showed a drain on state revenue. The two reports that found film incentives did pay for themselves were biased as they were financed by the Motion Picture Association of America or state office of film and tourism.

⁵⁴ McDonald, *supra* note 7, at 132.

This comparison creates confusion about the impact of the credit on the budget. While it is true that film incentives induce new productions resulting in private spending, the revenue generated from this new economic activity does not raise more money than the cost of the incentive to break-even or even generate enough revenue to offset a significant portion of the cost.⁵⁵

Also, there is the aforementioned issue of transferrable tax credits, resulting in the tax credits not being limited to a production's actual tax liability. Because productions are permitted to sell or transfer tax credits to third-parties, Pennsylvania is losing revenue from those third-parties, and policymakers cannot maintain that the FTC program only forgives tax liability that would not have existed anyway.⁵⁶

Further, these studies often do not account for the simple but significant fact that some productions would likely have located to Pennsylvania without the tax credits. In fact, the majority of film productions have not applied for the FTC, suggesting that the actual response to the tax credit is likely well below the purported estimations.⁵⁷

Finally, the media and the supporters consistently refer to the number of jobs created by the FTC. However, this argument is problematic because the jobs that the supporters are referring to are mostly low-skilled, temporary jobs with little upward mobility.⁵⁸ The failure to account for the temporary nature of many film jobs leads to greatly exaggerated job creation estimates.⁵⁹ Professional and special skilled jobs are often outsourced, with the individual traveling with the production from state to state.⁶⁰ Moreover, many of the jobs "created" by the

⁵⁵ See *supra* note 53 and accompanying text.

⁵⁶ Robyn & David, *supra* note 24, at 4.

⁵⁷ Howard, *supra* note 13.

⁵⁸ Joseph Henchman, *Debate on Film Tax Credits in Pittsburgh*, TAX FOUND. (Apr. 13, 2009), <http://taxfoundation.org/blog/debate-film-tax-credits-pittsburgh>.

⁵⁹ Robyn & David, *supra* note 24, at 7.

⁶⁰ Henchman, *supra* note 58.

production are merely jobs that have shifted. For example, “a hairstylist might go from serving the public to crimping and curling on film sets.”⁶¹ These are just examples of how the lack of impartial reports regarding the FTC has created unfounded benefits popularized by the media and local film organizations. A closer look at the real costs of this program is necessary in order for Pennsylvania to decide if the FTC is really a strong state program.

CONCLUSION

When Pennsylvania first introduced the Film Production Tax Credit Program in 2007, it brought the excitement of a new industry, job prospects, and nationwide attention. Unfortunately, with the majority of its sister states vying for the same spotlight coupled with the gradually mobilizing nature of the film industry, the moment has come where Pennsylvania’s policymakers need to critically look at its FTC program and decide if its serving the best interests of its current taxpayers and industries. The legislature must look beyond the local media and their starry-eyed constituents and carry out more balanced studies to evaluate the real costs and benefits of the FTC. Moreover, the hard question of whether the funding allotted to the FTC program may better serve the state in another growing industry needs to be asked. These steps are vital to determine whether the Pennsylvania Film Production Tax Credit Program is a blockbuster hit or a hyped-up flop that needs to be cut.

⁶¹ Nathan Benefield, *Two Thumbs Down for Film Tax Credits*, COMMONWEALTH FOUND. (Jan. 15, 2010), <http://www.commonwealthfoundation.org/policyblog/detail/two-thumbs-down-for-film-tax-credits>.