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Policy Brief

The Public Affairs Research Council of Louisiana

Louisiana's Film Industry Incentives

Leaders must face the realities of the movie tax credit largesse and create a better program that truly benefits the state

Among Louisiana's tax credit and incentive programs, none have received more fanfare and attention than the Motion Picture Investor Tax Credit. The current version of the program, enacted in 2009, has contributed to explosive growth for filmmaking in Louisiana. For example, 60 tax credit film projects -- TV shows, films and commercials -- were produced in New Orleans in 2013 and led to an estimated \$456 million dollars in local spending, according to the city's Office of Cultural Economy.

This spring alone, Louisiana is host to productions of at least a dozen feature films and TV series packing a wow factor of major stars including Brad Pitt, Christian Bale, Steve Carell, Abigail Breslin, Jamie Lee Curtis, Matthew McConaughey, Chris Pratt,

To put the situation in stark terms, the Hollywood film industry is renting Louisiana, not buying it.

Denzel Washington and Kristen Connolly. In-state production spending and job growth have come as a result of the credit, and the increase in film projects have prompted some to refer to Louisiana as "Hollywood South."

But while the state's heavily subsidized film industry may be booming, there is reason to believe the motion picture tax credit is contributing to Louisiana's trend toward state budgetary bust. The film industry's status in Louisiana is frequently exaggerated;

Louisiana has not surpassed California as the nation's film capital. Many moviemakers essentially visit the state for temporary production purposes at subsidized rates rather than making long-term investments and establishing a permanent presence here. To put the situation in stark terms, the Hollywood film industry is renting Louisiana, not buying it. This observation is not intended as a criticism of the industry's practices; it is simply a recognition of how the business often operates.

In the midst of this year's state budget crisis and beyond, lawmakers and taxpayers must consider the whole fiscal picture, and this credit is not an exception. There has been a great deal of debate over whether state spending on film incentives generates a good return on investment. In order to tackle this problem, the nuts-and-bolts of the motion picture tax credit need to be understood.

Also, the state's incentive program must remain transparent. By and large, the film tax credits overseen by the Department of Economic Development have been handled with an open process in which documents and communications have been made public in a timely manner. A lack of openness has been a serious problem in some other states with film incentives. Louisiana must stay the course in releasing records to ensure a fair and fruitful public debate.

PAR's analysis of the program begins with a look into how film projects become eligible for taxpayer money and how the certification process keeps track of where Louisiana's dollars go. This process has specific impacts on the changes being proposed. It is a well-known fact that the state already has invested large sums in this program. Less well understood is the state's accumulation of liability for the credits. This report challenges some common assumptions and reviews the pros and cons of several proposed changes under discussion in the tax credit program. Recommendations for future action are included.

SORRY LOUISIANA, BUT YOU'RE NOT HOLLYWOOD, YET

Louisiana film industry promoters and uncritical media have touted the state as the new American capital of the movie industry. This claim appears to be based on rankings of New Orleans and Baton Rouge as favorable places to make films and specifically on a study published in 2014 by FilmL.A. Inc., the regional film office for Los Angeles, Calif. The study demonstrates that the major California studios are shifting production to other states, Canada and overseas. The main reason is financial. Louisiana has become a popular destination for these studios because of its appealing tax credits. California was encouraged by the study to respond with reformed incentives of its own. As of last year, such changes had already appeared.

The FilmL.A. report surveyed the 108 movies released in 2013 by six major studios and five so-called mini-major studios. These movies had budgets from \$1 million to \$225 million. The study found that 18 of those movies were "primarily produced" in Louisiana, which had more than any other location. California and Canada were tied for second at 15 apiece, followed by the United Kingdom with 12 and Georgia with nine. This significant finding marked a true milestone for Louisiana as an ascending player in the film industry. Some bragging rights were in or-

der. But this fact must be viewed in context with the deeper messages in the FilmL.A. report and a sober evaluation of the relative movie industry presence among the states.

Real infrastructure

What people call "studios" in Louisiana should not be compared with these big Hollywood studios, which initiate multiple major film projects each year. Some of Louisiana's studios are essentially specialty warehouses that offer services and equipment for films to rent out during production. These modern and versatile facilities are a major factor in luring movies to the state but they do not have the stature and influence of the Hollywood brands. Their role primarily is to provide California-based and other studios with means of production rather than originating creative content of their own.

There is also more to a movie industry infrastructure than studios. California has 78 accredited film schools including nine that are highly ranked. Louisiana's nascent university film departments haven't yet reached that

level of recognition **Is California losing film jobs and market share? Yes, but it still has most of the people, money and ideas that drive the industry.**

and the state so far has failed to focus on the creation of a designated center of excellence in this educational field. California and New York are the leading locations for film industry associations, guilds and unions. Small filming activities abound in California. In 2013 in the Los Angeles region alone, 584 unique feature films were shot on location, most employing crews of 40 or fewer people, according to FilmL.A. Of the 108 big-studio movies examined by the FilmL.A. report, only one used Louisiana as a "secondary location" (for only two weeks) compared with 11 for California.

A digital world

The FilmL.A. report also makes the critical point that Louisiana lags considerably in the competition among states and nations to provide a strong base for visual effects (VFX) production. This point is important because of the large numbers of jobs involved. Of the 25 live-action movies with budgets over \$100 million that were included in the FilmL.A. report, almost half of the total jobs associated with those movies went to VFX artists. Very little of that work was done in Louisiana. California's VFX work has been moving to London, Montreal, Singapore, India, Australia, New Zealand and elsewhere. One of Hollywood's most successful visual effects studios,

The bottom line is, Louisiana has distinguished itself as a rising star in the film business but it definitely is *not* the film capital of the nation.

are found in Texas, Connecticut, India, France, Canada and China. Louisiana has VFX and animation studios that operate in this fierce competition, but the state's growth in VFX production capabilities trails other locations considerably.

The bottom line is, Louisiana has distinguished itself as a rising star in the film business but it definitely is *not* the film capital of the nation. Moreover, the economic development challenge for Louisiana is not just to win more major film projects but to position itself in the emerging and converging entertainment fields of film, animation, digital interactive media, gaming, software and sound recording. Ultimately, the state's suite of incentives for these various entertainment businesses should be the broader focal point of a debate on reforms, as well as how best to make the state competitive and earn a good return on investment. Learning to thrive and build sustaining businesses in the new digital world may be more important than learning to imitate the old Hollywood world.

A THREE-STEP PROCESS

The current motion picture tax credit system began in 2009 when a round of major alterations to the program raised the incentive rate. The previous timeline of credit reductions was abolished and replaced with a more generous system with no sunset. These changes raised the credit to 35% for payroll to Louisiana residents and 30% for all other qualified in-state expenses.

With so many productions coming to the state to do business, it is important for lawmakers and taxpayers to understand how these productions gain access to Louisiana public dollars. The program is not really a tax break for movie makers but rather a financing mechanism to help pay for production costs. When a movie is about to be made, the investors usually register a discrete firm in Louisiana that becomes the main financial shell for that particular production. Neither the investors nor the firm are likely to acquire a substantial tax liability to the state of Louisiana. Even if the investors happen to be state residents, the value of credits in a typical film production will far outstrip their state tax liability. The investors want to earn tax credits because the instruments can be traded for cash. The credits are a subsidy or cash incentive, not primarily a tax reduction incentive.

There are three basic steps for investors in a production company to take advantage of the credit program:

Initial Certification. The production company submits an online application with supporting documents to the Louisiana Department of Economic Development (LED). Included in the supporting documents are preliminary budgets for the overall production and for spending in Louisiana.

The information submitted in the application is used to determine initial eligibility. At this stage very few applications are rejected unless a project is clearly not eligible (for example, if the budget is under the \$300,000 minimum expenditure threshold). Once

the application is approved, the production company receives an initial certification letter and is considered a "state-certified production." Productions have one year from initial certification to make qualified expenditures, though this can be extended with permission from LED. At this stage, the production company is under no obligation to make any actual expenditures. If a proposed film project falls through for whatever reason, no penalty is placed on the producer and no credits are awarded.

Final Certification. After the project has incurred expenses, the production company may apply for Final Certification. At this stage a more detailed review is done to ensure the production's expenditures meet state laws and regulations. The moviemakers submit documents showing their in-state expenditures. These expenditures must be audited by an independent CPA licensed in Louisiana in conformance with generally accepted accounting principles as well as the regulations of the program. LED might ask for additional clarifying information and some submitted expenditures might be rejected. The auditing phase may last no longer than 120 days. Once a final determination on the level of qualified expenditures is made, LED grants the appropriate amount of tax credits. The production company is under no obligation to finish a project or publicly release or air a motion picture. The qualified spending – not the final product -- is what earns the credits.

Tax Credit Redemption. Once the tax credits have been granted, the production company is then permitted to monetize them. There are three routes to doing so:

- The first is to use the credit to offset any state tax liability the company might have in Louisiana. With this method, the credits can be used only up to the amount of a firm's or an individual's state tax liability. However since most investors and production company studios are not located in the state, this option is used rarely by out-of-state moviemakers.

- Owners of the tax credits can exercise a cash buy-back option and return the credits to the state in exchange for 85% of the face value. So a company with \$1 million in credits could redeem them for \$850,000 directly from the state. The Department of Revenue writes the checks. The Legislature does not appropriate this transaction and cannot interfere with it.
- The last option is to sell the credits to an individual or company that has a state tax liability and who can use the credits as a tax offset. For example a movie producer with \$1 million in credits could sell those to a Louisiana company for \$900,000. Both players win in the transaction. The moviemaker gets a lot of cash and the in-state company can use the full value of the credits to offset \$1 million worth of Louisiana tax liability, making a \$100,000 profit on the deal. Tax credit brokers are sometimes used to facilitate these transactions. Unused credits can offset tax liabilities for up to 10 years.

Timelines

The process from initial certification to credit redemption can take a year or often more. Consider the movie *Ender's Game*, for example. The production company -- registered in Louisiana as Ender's Game Productions NOLA Inc. -- submitted an application on Nov. 18, 2011, with an initial in-state spending estimate of \$53.3 million, of which \$11.8 million was to be labor costs for Louisiana residents (and thus eligible for the 35% credit). That made the estimate in future potential tax credits roughly \$16.6 million. Initial certification was approved on Dec. 16, 2011. The production company made the movie, spent more than anticipated and submitted its Louisiana spending data for an audit. The final certification was granted Nov. 16, 2012, for

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credits worth \$17.9 million. The producers chose to redeem those credits by transferring them to the state for 85% of their value and thus received a check for about \$15.2 million.

Had the *Ender's Game* moviemakers used a broker or sold the credits to a person or company paying taxes in Louisiana, those credits could have been used to offset taxes until as late as 2022. So, the time between initial certification and the actual impact on the state's finances is likely to be one or two years and could be even longer.

APPLYING CAPS

Understanding each stage of the movie credit process is important for any discussion of possible reforms. It is this multi-year process that commits the state to certain long-term financial obligations and therefore limits the state's ability to produce immediate budget savings through reforms to the program. Because film projects can begin production under the assumption that their credits are going to be paid out in a timely manner, the state is on the hook for whatever the final production costs turn out to be after final certification.

The most commonly discussed reform proposal is an annual cap that would contain the state's cost of the program. Discussions of adding a "cap" require a determination about what phase of the credit evaluation process should be capped. Should the cap exist at the initial certification, final certification or redemption stage?

A *cap on total initial certifications* could result in moviemakers padding their initial budgets and a rush of applications. If a production company failed to get started or did not follow through with the proposed spending, then the initial certification cap could block other willing and able moviemakers from the credit program. A *cap applied at the redemption stage* would in theory guarantee a limit on the state's financial exposure year to year; however, this cap could delay the cash or tax benefit that was rightfully earned by an individual or company. The

state would be offering a guaranteed credit that it could not necessarily honor in a timely manner, and legal challenges

could follow. **This multi-year process commits the state to certain long-term financial obligations and therefore limits the state's ability to produce immediate budget savings through reforms to the program.**

Many a movie-maker could be holding valid but unrequited credits, and the state could be faced with a large backlog of state liabilities. This situation in effect could cripple the financial incentive program.

A *cap on total final certifications* would limit the state's financial exposure in the long run; the amount of actual credit usage could vary year to year but the variations are likely to be unsurprising and eventually would converge near the cap level. Production companies would have an incentive to complete their motion pictures expeditiously. Once certified, the credits could be monetized without delay. While not perfect, a cap on the final certification is the most effective, fair, legal and logical stage to apply a limit, if a limit is applied.

A *rolling cap* is the most likely way that final certifications would be limited. For example, once the state issued its annual limit of final certifications, the movie-makers next in line would wait until the following year to get their certifications. This system is first-come, first-serve. Eventual approval of properly qualified certifications would be guaranteed, but the period of delay in getting them might be long. The state's financial exposure would be limited and would become fairly predictable; however, the backlog of moviemakers awaiting their certifications could become a policy problem and could impact the appeal of the incentive program.

THE CREDIT BACKLOG

To get an idea of how the current certification process makes an impact and creates a backlog for the state's budget, Table 1 lays out the figures associat-

ed with each phase of the certification procedure every year from 2010 to 2014. The first two steps – initial and final certification – are administered by the Department of Economic Development.

During this five-year period, motion picture makers got approval to proceed with projects representing more than \$5 billion in spending. (See table 1, column 1.) In those years, actual final certification of credits was \$3.3 billion. (See table 1, column 2.) Does this mean the state is facing a backlog of \$1.8 billion in potential certifications? No. Many proposed projects stall at the starting line or else spend less than anticipated. Initial certifications are valid for only a year, although they can be extended. Some amount of certification backlog exists but it is kept in check by the deadline.

For example, in 2014, the state gave initial certification to applications with projected in-state expenses of \$865 million. That same year, final certifications were approved for a total of \$727 million in spending, which represented \$226 million in credits. These

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final certifications were largely the result of productions that received initial certifications in previous years but had completed work and auditing by 2014.

Each year there is always a backlog of previously approved productions that finally are ready to turn in their spending reports and obtain their credits.

In the five-year period, a total of more than \$1 billion in tax credits was certified. (See table 1, column 3.) Some portion of those credits is going to be redeemed in later years. The state will not feel the fiscal impact of certified credits until they are redeemed.

About \$580 million in credits were used as tax offsets during these years. (See table 1, column 4.) That means state tax collections for corporate and personal income were \$580 million lower as a result of the credits. Credits worth \$357 million were turned into the state in exchange for cash at the rate of 85 cents to the dollar. Those rebates cost the state \$303 million. (See table 1, column 5.) So, for those credits, the state saved \$54 million by issuing cash rebates instead of tax offsets. With the tax offsets and rebates combined, the total cost to state revenue from 2010 to 2014 was \$883 million. (See table 1, column 6.)

In summary, final certified tax credits in this period created a \$1 billion liability for the state. Meanwhile, \$937 million in credit liabilities were wiped off the books. So for this period of study there was a \$63 million net liability of certified tax credits that the state would still have to meet eventually. Factoring in additional unmet obligations from before 2010, the backlog would be even higher. There is also momentum from initial certifications during this period that are going to become final certifications after 2014. Not included in this chart is the level of final certifications for 2015, which is on track to set a new annual record of more than \$250 million.

Because of this built-up liability, even if the state canceled the program and stopped certifying tax credits as of 2016, the state would still have substantial liabilities and its revenue would continue to be significantly affected by the program for at least one or two more years.

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TABLE 1: Three-Step Certification Process

The Louisiana Department of Economic Development (LED) and the Louisiana Department of Revenue (LDR) each keep track of costs incurred by the film credit program. Below are estimates for the annual costs of the program at each stage of the three-step certification process over the previous five years. The first two columns show estimated and certified in-state spending by film productions. The remaining columns take a look at where the final costs to the state fall in the certification process.

Year	Initial Certification	Final Certification		Credit Redemption		
	Estimated Spending	Certified Local Spending	Certified Tax Credit*	Tax Offset	Rebate	Total Impact on State Revenues
2010	\$898,870,202	\$329,921,022	\$102,509,948	\$125,778,185	\$23,280,222	\$149,058,407
2011	\$1,432,825,725	\$673,026,991	\$207,944,556	\$87,176,422	\$62,660,337	\$149,836,759
2012	\$742,283,629	\$717,175,057	\$222,801,995	\$94,514,450	\$109,722,108	\$204,236,558
2013	\$1,112,310,327	\$809,780,156	\$251,148,572	\$104,468,842	\$35,574,161	\$140,043,003
2014	\$865,529,971	\$727,055,600	\$226,417,042	\$168,335,413	\$71,887,489	\$240,222,902
Total	\$5,051,819,853	\$3,256,958,826	\$1,010,822,112	\$580,273,312	\$303,124,317	\$883,397,629
Source	<i>LED</i>	<i>LED</i>	<i>LED</i>	<i>LDR</i>	<i>LDR</i>	<i>LDR</i>

*Includes 5% credit for in-state labor

LOUISIANA'S COMPETITORS

The competition between states and even countries to host film and television production projects is fierce. While there are several generous programs, Louisiana's 30% base credit is among the highest. A number of states have scaled back their efforts because they did not see a good return on investment. Even in places where these incentives have proven successful in luring productions, competitors have changed their programs to adapt to the new market environment. Some of these changes are intended to be more competitive while others are meant to reduce the impact on the government's fiscal bottom-line. A few, such as California, have attempted both. Beginning on Jan. 1, 2016, California will increase film credit funding to \$330 million dollars

each year for the next five years. That is over three times the amount previously credited under California's old system. The legislation passed the state Senate and Assembly overwhelmingly and was approved by Gov. Brown on Aug. 17, 2014. At present, productions must bid in a state lottery system to qualify for the incentives. This system will be phased out and replaced by a merit based selection program. Projects will be chosen based on a competitive jobs-to-wages ratio for each production. Tax credits will be made available to a wider spectrum of projects, including big-budget feature films, one-hour TV series and television pilot episodes. The annual state funding program is divided into separate incentive packages tailored to each of these categories.

TABLE 2: Motion Picture Tax Credit: Comparative Overview

Many states and foreign countries have adopted incentive programs to attract business from the film industry. Below are some comparisons of Louisiana and its competitors.

State	Incentive	Incentive Type	Per-Project Cap
Louisiana	30% + 5% on resident labor	Transferable tax credits; can be transferred to state for 85% return value	No cap (5% on resident labor only available for the first \$1 million)
North Carolina	25% until 2015	Refundable tax credit	\$20 million project cap until 2015 and now a \$10 million grant program
California	25% or 20% depending on project qualifications +5% resident labor	Refundable and transferable tax credit	Credit applies to first \$100 million of feature films; first \$10 million of independent films; \$330 million annual program cap
Georgia	20% + 10% for qualifying Georgia promotion	Transferable tax credit	No project cap
South Carolina	30% Services; 25% for resident labor; 20% for non-resident labor	Refundable and transferable tax credits	No project cap
New Mexico	25%+5% for qualifying TV-series	Refundable tax credit	No project cap; \$50 million annual program cap
New York	30% percent of qualified production costs; + 5% post-production costs in Upstate NY; +10% on qualified labor.	Refundable	No project cap; \$420 million annual cap
Ontario, Canada (OFTTC)	35% on qualifying labor +40% of first \$240,000 for first-time producers	Refundable tax credit	No project cap
Ontario, Canada (OPSTC)	25% for qualifying production expenses; +16% for qualifying labor	Refundable tax credit	No project cap
Ontario, Canada (OCASE)	20% for qualifying computer animation labor	Refundable tax credit	No project cap

As California struggles to retain and attract filmmaking, the leading horses in the North American competition are Georgia, New York and the Canadian provinces of Ontario and British Columbia. New Mexico has been competitive but has capped its financial exposure while South Carolina recently has been pressing strongly for a bigger market share. Several states have backed off their previously more expensive subsidies. For example, Michigan once had a 42% film credit but soon surrendered the program because it was too expensive.

A unique feature of the Georgia tax incentive program is the 10% added credit given to productions that promote the state of Georgia within their product. The state provides producers with an approved promotional logo to be incorporated in the finished version of the film or TV series. This bonus places Georgia on a near-equal level with Louisiana and emphasizes incentives for films that actually are completed and released for public consumption.

New York has both a production and post-production credit. The program has an annual cap of \$420 million that can be allocated to production costs, of which \$25 million is reserved for post-production costs. Work in certain counties is eligible for an additional 10% credit, capped at \$10 million.

Ontario offers three variations of film tax credits available to producers. The Ontario Film & Television Tax Credit (OFTTC) is available for “a Canadian corporation which is Canadian-controlled, has a permanent establishment in Ontario, and files an Ontario corporate tax return. In addition, the individual producer of the production must have been an Ontario resident for tax purposes at the end of both of the two calendar years prior to commencement of principal photography.”

The Ontario Production Services Tax Credit (OPSTC) is available for a “Canadian or foreign-owned corporation which carries on a film or video production, or production services business, at a permanent establishment in Ontario, files an Ontario

corporate tax return and owns the copyright in the eligible production, or contracts directly with the copyright owner to provide production services to an eligible production.”

The Ontario Computer Animation & Special Effects Tax Credit (OCASE) is available for “a Canadian corporation that is Canadian or foreign-owned, has a permanent establishment in Ontario and files an Ontario corporate tax return. Qualifying corporations may include animation or visual effects houses, post-production houses and film and television production companies which perform eligible computer animation and special effects activities.”

British Columbia, and the city of Vancouver in particular, has achieved success in growing its film industry by incentivizing local labor expenditures, digital animation and visual effects, as well as training programs for industry workers. Unlike most other credit programs, British Columbia offers generous credits that reward productions that rely heavily on qualified labor expenditures made within the territory. This local approach takes three forms: a basic credit of up to 33% of labor for companies with eligible labor costs; increased incentives for shooting in regional locations outside of the Vancouver area; and a 17.5% credit for digital animation labor.

Louisiana could learn from British Columbia’s emphasis on local investment.

Louisiana could possibly learn from British Columbia’s emphasis on local investment. One of Hollywood’s most successful visual effects studios, Sony’s Imageworks, transferred its home from California to Vancouver last year. The studio was responsible for major productions like “Edge of Tomorrow” and “The Amazing Spider Man 2.” British Columbia’s focus on investment in local infrastructure and workforce training has provided the city of Vancouver with a fast-growing share of the production pie. This year alone, Vancouver is hosting the production of 29 films, including the upcoming

"Deadpool," "Star Trek 3" and Steven Spielberg's "BFG." British Columbia's incentive program has many nuances to promote local jobs and investments.

In North Carolina, the Legislature chose to rein in the state's incentives because of the cost and the belief that the state dollars could be invested more wisely. The saved funds are being redirected toward small-business tax breaks. The new film incentive beginning this year is a \$10 million competitive grant program. Film projects can bid for the one-time grant.

ECONOMIC AND FISCAL IMPACT

While the growth of Louisiana's film tax credit program has created an impressive haven for film and television producers, many state observers have raised concerns about the fiscal impact on the state budget. Economists and commentators have argued that Louisiana is not receiving a net benefit from these incentives and that the program does not amount to a good return on taxpayer investment.

Financial impact studies were conducted by Loren C. Scott & Associates on behalf of the Louisiana Department of Economic

For every \$1 invested by the state in film tax incentives, the state recovered only 23 cents from taxing the resulting economic activity.

Development and the Office of Entertainment Industry Development in 2013 and 2015. These studies are required by law to be conducted every two years. The latest study says \$776.3 million was spent on film productions in Louisiana in 2014, supporting about 4,200 direct jobs. The economic ripple effect supports workers in goods and services jobs outside the film industry. A total of 12,107 direct and indirect jobs were supported by film industry spending in the state. Workers who pay taxes in Louisiana help return money for the state's investment. For fiscal year 2014, Scott estimates a \$171.4 net loss to the Louisiana

state treasury from the motion picture tax credit. For every \$1 invested by the state in film tax incentives, the state recovered only 23 cents from taxing the resulting economic activity.

All expenditures are not equal

There is reason to believe that the economic impact of the film tax credit program is overestimated. Production companies receive credits based on costs they incur

while filming in the state. However, such "costs" do not necessarily equate to in-state spending as economists would see

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it. Economic models that estimate multiplier effects assume that dollars are spent in the state. With film production, some spending is unlikely to result in a ripple-effect for Louisiana's economy. (See sidebar on above the line and below the line).

Many of the people employed in Louisiana film production do not reside in the state. Major movies require teams of support workers who come from around the country to gather at shooting locations. A person who works on a temporary project in Louisiana but lives outside the state is unlikely to make major purchases in Louisiana. Non-residents are less likely to visit the dentist or doctor on routine visits, acquire insurance and permanent housing or purchase durable goods -- such as a car, TV or appliance -- in Louisiana. A temporary resident would not have the same economic impact on the state as a permanent resident. This dulling effect would be even greater for high-salaried talent who live elsewhere.

Scott states that it is a "heroic assumption" that payments made to talent, writers, directors and producers will actually be spent in Louisiana. This could exaggerate the impact of the film production credit by as much as 27%. Based on the analyses of nearly every study conducted on the economic im-

pact of the motion picture tax credit since 2009, with the sole exception of an industry-backed study,¹ there is little doubt that the program has had a negative impact on state revenues.

One reason to continue the film tax credit program is the expectation that the state's investment in the long-term will lead to the growth of a "native" film industry. The hope is that as movie productions spend more money in the state, local businesses will crop up to help serve their needs. Louisiana companies such as Hollywood Trucks and Celtic Studios have done well renting their services and facilities to movie production companies. The state has given some local companies a special subsidy. For example, Hollywood Trucks received \$6.8 million through a film infrastructure tax credit program, which has been phased out. A few Louisiana companies, such as Moonbot and Millennium studios in Shreveport, initiate film projects. Most other companies simply service productions brought in by out-of-state movie-makers. A study of this issue by Dr. Patrick Button of Tulane University found that most film incentives "have a moderate effect on filming location, but almost no effects on employment or establishments."²

¹ According to the LFEA (Louisiana Film Entertainment Association) study, local and state tax revenues resulting from increased tourism offset or exceeded the estimated cost of the motion picture investor tax credit in 2013. Assuming the tenuous impact of tourism is correct, this claim applies to the cost of redeemed credits for that year, not the final certification cost provided by LED. Furthermore, the effect of tourism only offsets the cost of the program when local and state tax revenues are added together. Even when LFEA's estimates for the effect of tourism are included, the net loss to state-level revenue is still clear.

² Button, Patrick. 2014. "Do Tax Incentives Affect Business Location? Evidence from Motion Picture Production Incentives." presentation to the Canadian Economics Association Annual Conference.

Above the line and Below the line

An important concept in entertainment financing is the difference between "above the line" and "below the line" costs. Above the line refers to costs associated with individuals such as screenwriters, producers, directors and actors. Above the line expenditures reflect the expected line item compensation for those individuals on a project. The amounts are usually negotiated in advance of any principal photography. "Below the line" expenditures refer to the actual costs of production. This would include, but not be limited to: grips, camera operators, hair and make-up experts, costumes, carpentry and set creations, editing, catering, extras, etc. The origin of the terms comes from early studio budgeting that had an actual line separating "above the line" and "below the line costs." The difference is relevant to a policy discussion since below the line costs, because they are more likely to re-circulate in the local economy, will have greater impact on the local economy than above the line costs. For example, money spent on creating a set in Louisiana is more likely to be spent in Louisiana than money going to an out-of-state actor who is part of that same production. Actors, producers and directors who are not Louisiana residents will tend to spend their earnings in their home state.

A REVIEW OF POLICY OPTIONS

A host of different modifications to the film tax credit program has been discussed. These proposals generally fall into three categories: *radical reforms* that would either eliminate or fundamentally change the program; *major reforms* that would have a serious impact on the program but leave it in place; and *functional reforms* that improve the inner workings of the current program. Lawmakers have proposed changes that would improve integrity and accountability. The options are reviewed below for educational value rather than as recommendations.

Radical Reforms

Eliminate the program. Given the high cost and inefficiency of the film tax credit investment, combined with the fact that many of its beneficiaries are wealthy out-of-state residents, a complete elimination of the program should remain under serious consideration if the program continues in unlimited, unchanged form. State revenue savings from a program elimination would not be felt immediately, for reasons covered earlier in this report. A new sector of the state's economy, including the jobs and livelihoods of the Louisiana film workforce, would be jeopardized. The state's enormous investment, now approaching \$2 billion in credits and obligations, would be squandered, but further wasteful spending could be saved.

Appropriate the subsidy. The film tax credit program is a subsidy ensconced in the state's revenue structure. Since production companies have small state tax liabilities, they have little need of credits that reduce that liability. So, to be useful, the credits can be redeemed for 85% of their value or sold to companies and individuals in the state that can take advantage of them. This is just a cash payment with extra paperwork. Legislators would have greater control over the program if the tax credit was eliminated and replaced with an appropriation in the state budget. The appropriation process would provide greater scrutiny and would allow the program

to be prioritized with other state needs such as healthcare and higher education. However, since the program would be re-appropriated on a year to year basis, studios might be less willing to participate if there is a risk to their eligibility for future credits or subsidies. Film producers and industry leaders have consistently warned lawmakers that if they cannot rely on a stable program, they may choose to take their business elsewhere.

Eliminate transfers and redemptions. Many would view the film tax credit program as a success if it created more in-state productions. This could be accomplished either from major studios opening shop in the state or from the creation and growth of indigenous studios, such as the award-winning Moonbot studios started by Louisiana native William Joyce. Eliminating transfers and redemptions would mean that only the company that created the movie could use the credits associated with the movie's production. This would greatly reduce the value of the credits to out of state companies who would have much less incentive to work in Louisiana. However, in-state companies would still benefit, assuming they are profitable.

Major Reforms

Cap the program. Some have called for the creation of an overall cap to the program, similar to what exists in New York and California. A cap limits total exposure to the state budget and could give the state better predictions about the cost of the program. At a price of sometimes more than \$200 million per year, the program is a major factor for the state budget. It is on track to reach \$270 million or more in certifications this year. In its current unlimited form, the Louisiana film tax credit program is vulnerable to the occurrence of a few very large productions that could severely reduce state revenues. Serial blockbusters with huge package prices are being filmed elsewhere. One day such a project could come to Louisiana and run up a huge tab.

Most caps are “rolling caps” that delay certifications or allow unused credits above the cap to be claimed in future years. The longer the delay in obtaining final certifications or credits, the more likely film makers might look elsewhere. Smaller productions might get crowded out by larger, more expensive films. A cap could work on a first-come first-serve basis, or a more complicated bidding process. Also a cap could either be set on the number of credits that can be redeemed in a year (like New York) or on the number of credits granted in a year (during final certification). The state might also consider a cap on both of those stages of the process, if it can be done legally with respect to the state’s contracts with film makers.

A rolling cap at the final certification level is the leading cap option for Louisiana. Once a movie maker gets the certification, the credits can be monetized right away. But the future problems created by such a cap should not be ignored. Film makers who qualify for final certifications in a particular year may not be able to obtain those certifications that year due to the cap. They will have to wait in line the following year on a first-come first-serve basis. If a lot of film makers are in that position, the backlog would grow and the delays in receiving certifications could be a deterrent to new film productions. On the other hand, the delays would serve to moderate use of the program, which is the goal of a cap.

Also, the state’s financial liability would be commensurate with the amount of qualified spending, even if that spending goes above the certification cap. A rolling cap on final certifications will not limit the state’s potential ultimate liability to the movie makers who have earned credits but have not yet received them. Eventually the state will have to meet its obligation to those film makers. The backlog could grow to be substantial.

Cap each production. A cap on how much any one production can claim would limit the impact of big budget blockbusters, which tend to have a relatively

poor return on investment. To the extent that these large productions have higher “above the line” costs, a production cap could improve the economic impact of the program by encouraging small films that are more likely to be made by locals. A production cap would also alleviate fear that smaller productions would get crowded out by large production if an overall program cap was instituted. If an overall cap is placed on the state’s tax credit program, then a production cap will be essential.

Cap “above the line” credits. As previously discussed, above-the-line spending on out-of-state actors, directors, and producers has a dubious impact on the local economy. The state should impose limits on the amount of above-the-line spending that can qualify for tax credits. One possibility would be to set a dollar limit. Such a cap would tend to affect larger films.

Another proposal would be to cap above-the-line spending at a certain percentage of a production’s total spending in the state. A current proposal suggests that such a cap should be placed at 50% for above-the-line spending. This proposal has led some people to think that above-the-line spending would only be counted at half value; that is not the case. Movie makers would be able to get full credit for all above-the-line spending up until the point that such spending reaches half the film’s total production budget. In PAR’s analysis, that proportion is too high and would have little impact, based on historical spending patterns. This is not a real reform or limit on the program and the public should not be fooled by it.

Reformers should instead look at eliminating the credit for above-the-line spending altogether or limiting the amount of above-the-line spending that can be eligible for credits. One idea would be to lower above-the-line reimbursement rates to 10% while increasing other reimbursement rates, such as for using in-state labor. This change would encourage spending that would have greater impact on the Louisiana economy.

Eliminate the break for soft costs. Soft costs are expenditures such as bond and finance fees and air-fare that have been identified as having a limited impact on the state economy. The state economic development agency and economists have recommended this change.

Sunset the program. The Department of Economic Development (DED) undergoes sunset review every five years but the film tax credit program, which DED administers, does not. Sunsetting the program after a five-year period would allow legislators to review the program and decide whether it is worth the costs. On the other hand, some studios have claimed they will do business in other states if Louisiana adopts a recurring sunset. The reasons are similar to those mentioned in opposition to other reforms: if producers and investors sense that changes to the program might risk the stability of their credits, they will be less likely to invest in the industry and infrastructure of our state.

Bidding process. Combined with a cap, a bidding process has projects submit proposals to the state. Those proposals would then be ranked by economic impact and only the highest ranked proposals would receive credits. This is the new system adopted by California. In theory this approach maximizes the impact of the projects that receive credits. However it might also be a large administrative burden on both the state and the production studios. California's system is too new to evaluate how well it is working.

Incentivize investment in local content. To promote local creative talent, extra credit could be given to local intellectual property. Any costs a producer incurs when obtaining locally copywritten work would receive an additional 5% to 15% credit. This could apply to screenplays and novels to original music that is used as part of the film.

Bigger incentives for TV series. A recurring television show might have a greater impact on the local economy than a single film. Accordingly, TV shows

could be made eligible for better incentives. This approach could include setting aside a certain amount of credits for TV shows under a cap system or increasing the percentage rate for credits. This change is predicated on the idea that TV shows produce a greater local economic effect than movies, which may not always be true.

Lower threshold for Louisiana filmmakers. If the long term goal is to encourage local film makers and foster local industry growth, lowering the \$300,000 project threshold could help these film makers get on their feet. This would allow additional smaller, independent, and local production companies to take advantage of the credits more easily. A lower threshold could increase the cost of the program without any benefit if the newly eligible film projects would have been shot anyway.

One proposal would lower the eligibility threshold to \$50,000 of in-state spending. However, it also would open the program to types of film products that were not intended to be included, such as political ads. The \$300,000 threshold has served to preclude cheap pornography videos from obtaining the state tax credits. Even if the threshold were reduced, the state has an additional regulatory safeguard (based on federal registration of actors in sex films) to prevent tax credits granted for films showing real sex acts. If the threshold is lowered, policymakers would need to evaluate whether unintended film projects are able to get state support.

Increase buy-back redemption to 90%. Under this proposal, the tax credits could only be transferred to another party once, and the state's buy-back would increase from 85 cents on the dollar to 90 cents. Such a change would greatly reduce, but not eliminate, the number of credits transferred. This could also reduce the amount of fraud currently surrounding the program as the market for credit trading would virtually disappear.

While it seems counter-intuitive, increasing the redemption rate could save the state money. Credits

that are transferred to a company are used to offset the tax liability of that company for the full 100% of the credit's value. If that same credit was instead redeemed with the state in exchange for cash, the cost to the state would be worth 90% of the credit's value, for a savings of 10%.

This change could cost the state additional dollars since every credit that would have been redeemed for 85% would now be redeemed for 90%. How many users of credits as a 100% tax offset would have to change their minds and use the credits for a 90% cash redemption in order for the state to at least break even as a result of the change? Based on historical patterns, if 31% of the credits earned as tax offsets had instead been traded in at 90% value, the state would have about broken even. If the cash rebate had been offered at 88%, then only 18% of those tax-offset credits would have needed to use the rebate in order for the state to break even.

Functional Reforms

There are a number of functional reforms that could improve the performance of the program without significantly changing it. Many of these reforms help enforce what should already be happening under the current law by attempting to prevent fraud or illegitimate transactions. These changes include:

Independent auditors. Each project would be responsible for paying for an independent audit of every entertainment tax credit application it submits, including those for digital interactive media, sound recording investors, musical and theatrical productions and research and development

A final sunset date for motion picture infrastructure tax credits to be used. This program was sunset in 2009, but tax credits would exist past this date.

Withhold income taxes. Most actors are not paid directly by a production for their performances, but are rather paid through "loan-out" companies set up inside the state where the movie is filmed. This al-

lows actors to maximize their tax benefits by avoiding a state income tax liability. However, if a production is going to claim that actor's salaries should qualify as in-state spending in order to receive more credits, then the taxes due on that portion of their spending should be withheld.

Eliminate illegal awards. Require that film tax credits awarded incorrectly or illegally would be returned to the state.

Resident verification. Since costs for resident labor receive a 35% credit, instead of a 30% for non-residents, there is incentive for a production company to overstate the amount of in-state labor used. This reform would mandate the use of already existing state processes to verify that those who are claimed as Louisiana residents actually live here.

Regulate related party transactions. A movie studio might have several subsidiary companies. Transactions between these related companies might be perfectly legitimate, but they have also been used to inflate expenses to create additional credits. Regulating these transactions more closely could help prevent studios from artificially inflating their production costs

Register film brokers. Film credit brokers would be required to register with the state before engaging in credit transactions like investment brokers from other industries. This registry could reduce the amount of fraud that is committed by holding brokers to industry standards, but it could also add an unnecessary layer of regulation and administrative costs.

PAR RECOMMENDATIONS

Louisiana would unquestionably benefit from an affordable incentive that truly builds a home-grown business base for the film industry and helps diversify the economy while attracting people to move here. Unfortunately, the extraordinary expense of the credits and the transient character of the industry itself work against this objective. The incentives

have brought unprecedented opportunities and abundant activity, but at these prices that should not be surprising.

As we approach the \$2 billion investment mark, Louisiana's hold on the film business is still a fleeting one. We have a budding film service economy, but not much of a film making economy. So many people from out of state have legally taken the fruits of the program, and so many others have illegally abused the system, that the real value of the film credits for the Louisiana taxpayer remains in doubt. That's to be expected when Louisiana largesse meets Hollywood accounting.

From this point, the best direction for the state incentive program would be to concentrate resources less on investments in temporary big dollar blockbusters and more on opportunities in converging fields of digital creation and content, software and Internet innovations. Louisiana is trying very hard to copy old Hollywood at a time when old Hollywood is fading. Fortunately, a suite of existing incentives already form a basis for this strategic direction and should be honed as a collective effort. Unfortunately, the film credit program is continually reshaped in isolation from these other programs.

Short of eliminating the film credits, a number of reforms could improve the program's economic impact while limiting its fiscal drain.

An overall cap

PAR recommends that the program be capped. This change has its downside as well as some advantages. All in all, a properly implemented cap would be better than the unlimited arrangement we have now. There is simply too much financial exposure to the state. Once the program is capped, further reforms become more manageable because the main issue surrounding the program would no longer be its total costs but rather how effectively those credits are spent under the cap for the health of the local industry. A cap allows the state to target

its investments on economically sustainable projects while keeping the costs under control.

To accomplish this, the cap should regulate the number of credits granted during the final certification phase of the process. Once the cap is reached, any certifications awaiting final approval could roll over to receive approval the next year, thus creating a rolling cap. The state should decide the amount of certifications to be granted per year for a set number of years.

On the downside, a rolling cap on certifications will likely create a backlog of liabilities for the state. Once the state has given initial permission to a movie maker to make expenditures that award credits, the film company has a right to proceed and collect its duly earned credits at the end of the process, even if the wait for those credits is a long time. This financial circumstance will tend to favor major studios with banking resources. Ultimately, a cap on final certifications is not a cap on eventual and potential liabilities for the state.

A project cap

The state should cap individual projects. To ensure the overall cap is not swallowed up by a few large productions, a per-production cap should accompany an overall program cap. This system would tend to favor TV shows versus blockbuster productions. TV shows usually establish a longer production presence in a community than a single big movie.

An above-the-line limit

The state should significantly reduce the 30% rate granted for above the line spending tax credits. PAR recognizes that eliminating credits for above the line spending is probably politically infeasible and might drive off too many projects. However, it is poor fiscal policy to allow Louisiana tax credits to become a means for out-of-state studios to take money out of Louisiana without creating local economic impact. Additionally, this lower rate should not apply to writers, directors and actors who are

state residents, as that would defeat the goal of increasing an in-state film industry. The credit for in-state labor could be increased to compensate for the decrease in above-the-line credits for out-of-state residents.

A cap on credits for salaries

The state should place a cap on the amount of credits that can be awarded for expenses toward an individual's compensation, particularly for out-of-state residents. Credits for movie stars are supposed to be applied only toward the portion of their compensation that applies to their work in Louisiana. Even with that current restriction, the existing system allows large subsidies to individuals who are unlikely to spend much of their earnings in Louisiana. The Department of Economic Development has long recommended some type of salary cap, but this message has been unheeded. The task is complicated by the fact that an actor or other highly paid talent might receive compensation through one or more incorporated firms rather than from a straight salary check. From the state's perspective, compensation to an actor – whether directly to the individual or through a private firm -- should be treated similarly for the purposes of a credit cap on salaries.

Eliminate soft costs

The state should eliminate the award of credits toward the soft costs of bond and finance fees and airfare. These expenditures have a limited impact on the state economy and as such are not worth subsidizing. The Department of Economic Development and economic consultants have long recommended this change. The exception for in-state institutions seems to be of limited value to the economy in general and is not needed.

Re-evaluate definition of expenditures

The state should re-evaluate what counts as an expenditure deserving of a state tax credit. The rules regarding what qualifies as an in-state expenditure are the core ingredient of the program. A stricter set

of guidelines on qualified spending would lessen the cost of the program and focus the credits more squarely on true in-state business. The state should especially re-evaluate the rules allowing qualified spending to a source that is "a physical nexus with at least one full-time employee and posted business hours." This system is vulnerable to abuse by mailbox shops. The Legislative Auditor should study the practice and performance of the process for these expenditures.

Better audits

The state should include subject-matter expert reviews in the audits of movie spending. The audits that are currently being conducted are focused on the accounting of the productions, i.e., whether the numbers add up. Experts in film and television production should be consulted to see if the expenditures are reasonable in both scope and cost. This step would cut down on attempts to run up costs to maximize the subsidy from the state.

A film school center of excellence

The state should focus an effort on creating an internationally recognized film school. After spending more than \$1.5 billion in credits trying to build a film-making infrastructure in Louisiana, the state still lacks a highly ranked higher education program in the field. This initiative could be supported by direct investment or by siphoning off even a tiny portion of the investments being made by the state and the moviemakers. Many highly successful people in the film business never went to film school, but many other successful people have benefited from college-level training. Georgia, which is arguably Louisiana's chief competitor for film business, just created a multi-campus program under the new Georgia Film Academy.

The University of New Orleans has a thriving film program. LSU is expanding its offerings and creating a master's program in digital media. The University of Louisiana – Lafayette has digital software

programs. Baton Rouge Community College has production training. Loyola University is creating a new academic program. The private New Orleans Video Access Center is filling a critical need for training in the production service field. These positive developments are driven in part by the fact that these programs are popular and draw students who pay tuition. Each institution uses the program as a cash cow, and in some cases the film programs are subsidizing other departments at the colleges. Too much of the focus is on paying the bills into particular institutional silos rather than on establishing a competitive and alluring center of excellence in the fields of digital and film entertainment.

Louisiana's opportunity on this front is huge. Tuition rates at the major ranked film schools around the nation are astronomical, so the state can easily be competitive on a financial basis in attracting talented students from around the world. Whether based solely in New Orleans or centered in New Orleans with a synchronized program linking the various colleges, a center of excellence would be a major step in building an entertainment infrastructure and labor market in Louisiana.

Minor but important tweaks

Several tweaks to the system should be adopted. These include the functional reforms listed above. These are solid proposals that will improve the system. However, if these are the only proposals that pass, the film credit program will not be substantially reformed and our fundamental concerns with the

program will not be solved. It will just reduce the amount of abuse that exists within a broken framework and will continue to be a revenue burden for tax-payers.

The future

The long term goal should be a tax credit system with no rebates or transfers. The legislature might give the industry a suitable time to prepare for the elimination of these options, perhaps 10 years. If, after that period of time, large out-of-state producers want to take advantage of Louisiana's generous subsidy, they will have to set up shop here. If a local film economy has not taken off by then, especially as other reforms are adopted to target investment in local industry and talent, it never will.

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