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spotlight

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Not the Best of Both Worlds

Tax credit will not save movies but will lose money

KEY FACTS: **• A 25 percent income tax credit on film production expenses would cost the state $63.3 million more each year than the current 15 percent credit, which loses $11.2 million.**

• Ernst & Young estimated the state lost $0.02 on each dollar of tax credits assuming all film-related economic activity resulted from the tax credit.

• Past incentive increases failed to increase "motion picture and music production" share much past 0.04 percent of state GDP.

• Increasing the tax credit to 25 percent would cost the taxpayers a net $0.31 of each dollar in tax credits the first year, $0.33 of each dollar the second year, and likely more in succeeding years.

• Ernst & Young estimates of the fiscal impact of tax credits are higher than estimates produced by any other company or government agency. Its estimate for an expanded tax credit is much smaller than its estimates for tax credits in New Mexico and New York.

• The film tax credit takes tax dollars from across the state and inefficiently redistributes them to chosen communities.

Some state legislators are using the decision to film a Miley Cyrus movie in Georgia as an excuse to expand a tax credit for movie production in North Carolina.[1] The proposed corporate income tax credit would return 25 percent of the value of qualifying expenses to the production company, up from 15 percent now.

Supporters claim the movie credit creates new jobs and economic activity, but they base their claims in part on an Ernst & Young study that assumes any movies shot in the state since 2005 were the result of the existing film credit, though the state had a film industry long before that credit passed. There is no evidence that North Carolina's film industry experienced a significant increase as a result of the tax credit, either in state gross domestic product statistics or

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in the Ernst & Young report itself. The jobs associated with film production are short-term and 39 percent of wages go to non-residents. Similar reports by Ernst & Young for New Mexico and New York faced criticism in an internal memo at the Federal Reserve Bank of Boston.[2]

The General Assembly's own fiscal research staff estimated a negative fiscal impact of $11.2 million annually under the current 15 percent credit. This would expand to $74.5 million per year by 2013 with a 25 percent credit. Fiscal staff also urged caution regarding the Ernst & Young claims.[3]

Fiscal Impact Estimates of State Film Tax Credits

Date	State	Source of Estimate	State Fiscal Impact
March 2005	LA	Louisiana Legislative Fiscal Office	$0.17
February 2008	CT	CT Dept of Economic & Comm. Development	$0.07
June 2008	PA	PA Dept of Comm. & Economic Development	$0.24
July 2008	RI	Rhode Island Department of Revenue	$0.28
August 2008	NM	Arrowhead Center - NM State University	$0.14
January 2009	MI	MI Department of the Treasury/Legislature	$0.19
January 2009	NM	Ernst & Young	$0.94
February 2009	NY	Ernst & Young	$1.10
February 2009	LA	Economics Research Associates	$0.13
June 2009	MA	Massachusetts Department of Revenue	$0.15
June 2009	**NC**	**Ernst & Young**	**$0.67**
Average			$0.37
Average, Ernst & Young studies			**$0.90**
Average, excluding Ernst & Young studies			$0.17
			State & Local Fiscal Impact
May 2009	*PA*	*Economics Research Associates**	*$0.28*
June 2009	***NC***	***Ernst & Young****	***$0.92***

*State & local fiscal impact
Source: Adapted from Massachusetts Department of Revenue report, July 2009

Background Facts

In 2000, legislators created the Film Industry Development Account to provide incentives for filmmakers. It limited grants to $200,000 per production or 15 percent of the total cost of goods and services bought by a production company.[4] Legislators replaced this account with a more generous 15 percent tax credit in 2006.

With the 2006 change, a company with at least $250,000 in qualifying expenses on a production can take a business income tax credit equal to 15 percent of those expenses against its income tax. To qualify, the expenses must be spent in-state and can be goods, services, or compensation (compensation of more than $1 million for an individual such as a star actor or director is excluded). The maximum credit is a refundable $7.5 million.[5]

Gerald Prante of the Tax Foundation warns that there may be a "race to the bottom" with states giving away more each year in film incentives.[6] In addition to Georgia, 40 other states have some form of film incentive. Credits in 28 of those states are higher than in North Carolina. Louisiana, which already has a 25 percent credit, is considering expanding it to 30 percent.[7]

In 2005, before creating the 15 percent tax credit, North Carolina was home to 64 movie and television show productions, fifth most in the nation, but they generated just $300 million in related economic activity (including catering, hotel, and other services) or 0.09 percent of state GDP.[8]

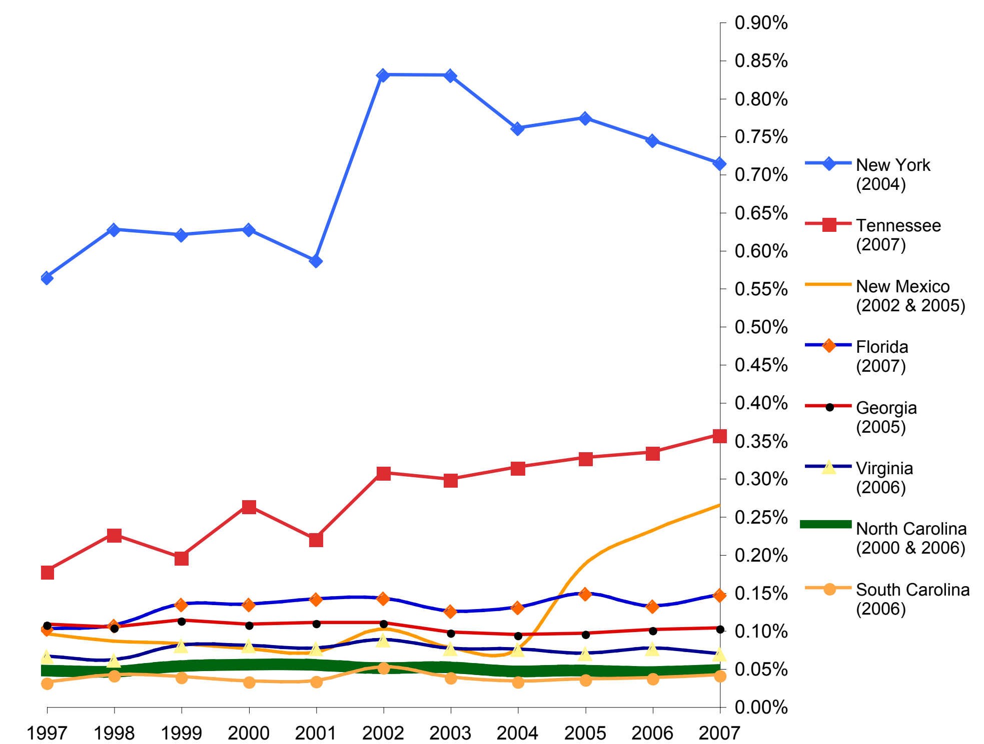
The motion picture and sound recording industries alone accounted for 0.04 percent of state GDP, just $142 million. That share is one of the lowest among neighboring states and has remained relatively flat between 1997 and 2007 despite expanding incentives.

Fiscal Pain, Little Gain

Despite claims by the North Carolina Film Office that a recent Ernst & Young (E&Y) study used "conservative" estimates,[9] it likely overstates the tax credit's impact. For example, E&Y assumed that all the film-related economic activity was a result of the tax credit. Looking at the state GDP figures, it seems more likely that almost none of

Lights, Camera, No Action

Tax credits have little impact on motion picture and music share of economy



Source: Bureau of Economic Analysis

the film-related economic activity was due to the tax credit.

Ernst & Young studies have consistently estimated much more positive fiscal effects than other private and government studies. Most studies did not count the potential effects of balanced-budget requirements on state revenue returns, but they still showed tax collections of just $0.37 for each $1.00 of tax credits awarded. In other words, the average state loses 63 percent of what it provides in tax credits. Excluding the E&Y studies, states lose 83 percent of the tax credits they offer.[10]

Even with its unrealistic assumptions and questionable methodology, however, the Ernst & Young study showed that state government loses $0.02 on each dollar in subsidies now and would lose $0.33 on each dollar with the larger credit.[11] The drain on the state budget in the next fiscal year, when legislators are working to impose new taxes, would jump from $11 million to $20 million.[12]

Tax credits take money from taxpayers across the state for the benefit of a select industry with a very localized impact. The studies on the fiscal impact of tax credits assume local governments do not have their own programs to attract film productions. As a result, they show the fiscal effect on local governments to be entirely positive. In North Carolina, Ernst & Young calculates local governments will gain $0.22 cents for each dollar the state gives in tax credits[13] and so directly transfer money from other parts of the state to areas with film production. But the local incentives and the distortions inherent in routing money through governments make state tax credits an inefficient way to redistribute income into local areas.

Other Questionable Claims

The Ernst & Young authors did not make clear how many jobs created would be permanent and how many short-term. Although the authors recognized that 39 percent of wages go to out-of-state residents, they assumed that half the wages would be spent in North Carolina. They presented no methodological justification for this assumption.

The authors also claimed that film production also generated three cents worth of tourism for every dollar spent on film production. But "attributing tourism spending to a film tax credit is difficult, if not impossible," according to a review of film tax credit claims for the Boston Federal Reserve.[14] Tourism spending due to film production may have little net effect if the result is drawing tourists from one attraction in the state to another – redistributing money in an inefficient way.

Conclusion

State government loses $11.2 million on the existing 15 percent income tax credit for film production. Expanding the tax credit to 25 percent of qualifying expenditures would increase the cost to $74.5 million. Estimates of the fiscal and economic impacts of film production overstate the positives and likely impact, but still show the expanded program would lose more money for taxpayers. The film tax credit shifts money from across the state to benefit one industry and some local areas, with no noticeable impact on the state economy or state tax revenue. Expanding the tax credit would cost even more with little, if any, net economic benefit.

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End Notes

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4. NC Session Law 2000-153: Senate Bill 1460.
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6. Gerald Prante, Tax Policy Blog, The Tax Foundation, March 29, 2008, www.taxfoundation.org/blog/show/23056.html.
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12. *Op. cit.*, note 3.
13. *Op. cit.*, note 11.
14. *Op. cit.*, note 2.