

Star Billing? Recasting State Tax Incentives for the “Hollywood” Machine

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I. THE *CURIOUS CASE* OF STATE FILM FINANCING: AN INTRODUCTION

As the end credits roll on *The Curious Case of Benjamin Button*, one of the most well-reviewed films of 2008 (and certainly one of the longest, clocking in at two hours and forty-seven minutes¹), some of the most important players in financing the film may be surprised to see that their names have been inexplicably omitted from the list of producers, not even earning the credit afforded to the numerous gaffers, dolly grips, and underwater camera technicians.² This group, whose credit has fallen the way

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¹ A.O. Scott, *It's the Age of a Child Who Grows from a Man*, N.Y. TIMES, Dec. 25, 2008, at C1.

² For an easily navigable version of the full credits of *The Curious Case of Benjamin Button*, see the film's entry available at the Internet Movie Database. Full Cast and Crew for *The Curious Case of Benjamin Button*, <http://www.imdb.com/title/tt0421715/fullcredits> (last visited Feb. 3, 2009). The author of this Note does not wish to suggest that gaffers, dolly grips, or underwater camera technicians are

of film on the cutting room floor, is the Louisiana state legislature. Thanks to an expansive tax incentive plan known as the Louisiana Motion Picture Incentive Act,³ the New Orleans-based production of *Benjamin Button* racked up \$27,117,737 in tax credits and exemptions, more than 16% of its nearly \$167 million budget.⁴ And in a time in which the global economy has the look and feel of a catastrophic tidal wave right out of a big-budget disaster film, the ability to save millions on a wide-release motion picture is nothing short of award-worthy.

Although early indications optimistically suggest that the film industry is now more lucrative than ever before,⁵ the uncertainty surrounding financial forecasting has Hollywood analysts and insiders rethinking the old truism that the box office is recession-proof.⁶ A city thought to be all glitz and glamour, Tinsel Town is being forced to tighten its belt, looking for new ways to cut costs and survive “[t]he fallout from declining local TV ad revenue, weakening DVD sales and diminishing sources of film financing.”⁷ To put it mildly, Hollywood is looking for a good deal—even if it means a change of address.

Intended to expand and feed local economies, entertainment-oriented state tax incentives like the Louisiana Motion Picture Incentive Act play a big role in luring film production companies away from traditional film production centers like Los Angeles to the state that can offer the best

undeserving of credit for their contribution to the film, but merely points out that a group responsible for financing a considerable portion of the film is not given producer recognition in the credits.

³ LA. REV. STAT. ANN. § 47:1124–1125.1 (2008). It must be noted, however, that the original Louisiana Motion Picture Incentive Act, under which *Benjamin Button* qualified, has been reined in following the conviction of Louisiana film commissioner Mark Smith, who admitted to accepting bribes to inflate film production budgets. See Gordon Russell, *Ex-Film Chief to Face Charges*, TIMES-PICAYUNE (New Orleans), Aug. 17, 2007, at A1; see also *infra* Part II.C.3.

⁴ Michael Cieply, *Jitters Are Setting in for States Giving Big Incentives to Lure Film Producers*, N.Y. TIMES, Oct. 12, 2008, at A26.

⁵ See Pamela McClintock, *Box Office Resists Recession*, VARIETY, Jan. 4, 2009, available at <http://www.variety.com/article/VR1117997933.html> (noting that the box office took in \$9.63 billion in revenue in 2008, up \$10 million from 2007).

⁶ Even during the Great Depression and subsequent economic slumps, Hollywood has been labeled “recession-proof” because consumers turn to the entertainment industry for escape from the frightening economic realities. See, e.g., Dawn C. Chmielewski & Meg James, *Downturn May Not Aid Studios This Time*, L.A. TIMES, Oct. 29, 2008, at A1 (exploring how the Internet may challenge this theory).

⁷ Claudia Eller & Richard Verrier, *A Bleak Picture for Big Studios*, L.A. TIMES, Jan. 2, 2009, at A1.

incentives, typically in the form of tax rebates and exemptions.⁸ These incentives have the effect of cutting a film's budget by as much as 42% in some states,⁹ an attractive solution to many of the budget concerns of the major studios. While many state legislatures view these programs as a positive step to create jobs, promote local business, and establish new industries within their respective states,¹⁰ others fear that proponents of such bills are merely star-struck and ignoring the economic realities attendant on such expansive tax breaks.¹¹

This Note is built on the following Parts. Part II of this Note explores the rationales of state legislatures when developing tax incentive packages for film studios, the short- and long-term implications of these packages, and how they impact other sectors of the state's economy. With those goals in mind, the Note will describe the different types of tax incentives, including exemptions of lodging, sales, and use tax, as well as the more comprehensive programs providing tax credits and state-backed loans. To contextualize these incentives, the Note will compare the unique, government-enabled film funding programs in three states: New York, New Mexico, and Louisiana.

In Part III, the Note looks at the current climate of the film industry at a time when old beliefs of a recession-proof box office are being tested more than ever before. Historically, bad economic periods translate into good news for the film industry, providing a relatively inexpensive departure from real life: two hours of escapism from the troubles in the world.¹² But in the age of the Internet, traditional beliefs about the entertainment industry are being questioned, and insiders worry that people may stay home rather than take a night out.¹³ The investigation will then turn to what some states are doing to

⁸ Lisa W. Foderaro, *Gone with the Cash: Films Go for the Best Tax Break*, N.Y. TIMES, Mar. 29, 2008, at B1.

⁹ See, e.g., CONN. GEN. STAT. § 12-217jj(b) (2009) (providing a 30% credit); MICH. COMP. LAWS § 208.1455(2) (2009) (allowing up to 42% in tax credits).

¹⁰ Press Release, Michigan Senate Republicans, Senate Approves Birkholz Legislation to Provide Job Training Credits for the Film Industry (Mar. 13, 2008) (on file with author).

¹¹ In Michigan, a state senator took to the press to deride the state legislature's plan in an opinion piece that declared, "[t]he film credit does not pay for itself." Nancy Cassis, *State Tax Credit Way Too Generous to Moviemakers*, DETROIT FREE PRESS, June 16, 2008, available at http://www.senate.michigan.gov/gop/senators/cassis/20080619_Cassis_DetNews.pdf.

¹² Michael Cieply & Brooks Barnes, *Americans Flock to the Movies, Seeking a Silver-Screen Lining*, N.Y. TIMES, Mar. 1, 2009, at A1 ("It's not rocket science . . . people want to forget their troubles, and they want to be with other people.").

¹³ See Chmielewski & James, *supra* note 6, at A17.

respond to the legislative push for new incentives to grab a bigger piece of the film industry from bordering states.

Part IV proposes a new basis for state tax plans, hypothesizing that the states that do not currently have a strong existing film industry should not rely on flat-rate, transferable tax credits. Instead, states should consider the true economic impact that a film production has on the local economy and develop a tax credit that directly correlates to the increased revenue realized as a result of the production. To create such a structure, states should look to urban redevelopment law and construct a version of Tax Increment Financing, where increased tax revenue directly attributable to a given project is paid back to retroactively fund the project.

Finally, Part V concludes with an optimistic outlook befitting a Hollywood ending.

II. MILKING THE SYSTEM: HOW STATE TAX INCENTIVES WORK

A. *State Rationales of Tax Incentives for the Film Industry*

In one of his most enduring songs, Irving Berlin famously noted that “there’s no business like show business,”¹⁴ and though film and television enjoy an air of otherworldliness, to the states hoping to capture a slice of the industry, it remains just what Berlin deliberately certified it: a business. In 2007, the domestic box office hit record highs, taking in \$9.63 billion in the United States alone and \$26.72 billion worldwide.¹⁵ These numbers appear to have increased in 2008, where early returns suggest that both domestic and worldwide totals were higher, even despite a slight drop in overall attendance.¹⁶

In the economies of film production, however, the states are not much concerned with the amount that consumers put in to the finished product. Rather, by attracting the production to be shot on-location, the states anticipate that small, local businesses will reap the benefits of having a big budget¹⁷ Hollywood film or television project settle for the long shooting

¹⁴ ETHEL MERMAN, *There’s No Business like Show Business, on ANNIE GET YOUR GUN* (1946 Original Broadway Cast) (Decca U.S. 2000).

¹⁵ MOTION PICTURE ASSOCIATION OF AMERICA, INC., ENTERTAINMENT INDUSTRY MARKET STATISTICS 3 (2007), <http://www.mpa.org/USEntertainmentIndustryMarketStats.pdf> [hereinafter MPAA 2007 REPORT].

¹⁶ Despite a 4% drop in attendance, the inflation of ticket prices was sufficient to mitigate the lost viewers and fueled the box office to record highs in 2008. McClintock, *supra* note 5.

¹⁷ According to the MPAA, the average negative cost in 2007 for an MPAA member motion picture was \$70.8 million. MPAA members include the major studios: Paramount

schedule.¹⁸ Hotels, restaurants, and bars see increased traffic, catering to the temporarily displaced cast and crew.¹⁹ Small, entertainment-oriented businesses like hair and make-up stylists may be called on to assist with the daily preparation of the cast, while nearby talent agencies are often called upon to provide extras and small bit actors.²⁰ Even local carpenters, equipment rental services, hardware stores, and laundromats get in on the picture, providing the raw material and labor for much of the behind-the-scenes technical work.²¹

Apart from expanding resident businesses, the states also recognize the value in creating an industry where one did not exist before.²² The Louisiana Department of Economic Development's Entertainment Industry Office recognizes that the purpose of its state tax breaks is to "encourage development in Louisiana of a strong capital base for motion picture production to achieve a sustainable, self-supporting industry."²³ To create an indigenous entertainment industry, several states have established an office for entertainment within the state's Economic Development division to oversee the promotion and marketing of the state as a site for production and to encourage the foundation of entertainment-oriented support businesses that rival the skill and expertise of Hollywood-based production groups.²⁴ Further, a state's development of an indigenous entertainment industry

Pictures, Sony Pictures Entertainment Inc., Twentieth Century Fox Film Corporation, NBC Universal, Walt Disney Studios Motion Pictures, and Warner Brothers Entertainment. The average budget for an MPAA affiliate (including MPAA member subsidiaries and specialty divisions like Fox Searchlight, Miramax, and Sony Pictures Classics) was \$49.2 million. MPAA 2007 REPORT, *supra* note 15, at 7.

¹⁸ See Glenn Rifkin, *Lights, Camera, Generous Tax Credit*, N.Y. TIMES, June 5, 2008, at C5.

¹⁹ *Id.*

²⁰ *Id.*; see also Michael Janusonis, *Jobs Are at Stake in R.I.'s Tax-Credit Debate*, PROVIDENCE J., Mar. 23, 2008, at B-01 (exploring the development and proliferation of small casting agencies and other entertainment support industries due to film tax incentives in Rhode Island).

²¹ Rifkin, *supra* note 18, at C5.

²² See, e.g., ALA. CODE § 41-7A-41(A) (2009) ("For Alabama to . . . foster a growing entertainment industry in Alabama, industry specific production incentives are immediately necessary.").

²³ La. Film & Television, <http://www.louisianaentertainment.gov/film/content.cfm?id=60> (last visited Jan. 31, 2010).

²⁴ FLA. H.R., FLORIDA'S ENTERTAINMENT INDUSTRY INFRASTRUCTURE: ARE WE GROWING THE INDIGENOUS INDUSTRY AS WELL AS SUPPORTING PRODUCTION? i-ii (2006).

involves a more consistent and predictable job market for those directly associated with skilled film production positions.²⁵

Even after the production packs up and leaves town, the film's release frequently sparks a new industry within the state: film tourism.²⁶ Through orchestrated marketing efforts as prominent settings in films, these locations frequently see better than a 50% increase in visitors over four years after being featured in successful films.²⁷ Nearly twenty years after the release of the iconic baseball picture *Field of Dreams*, tourists continue to reinforce that movie's prophetic stanza of "If you build it, they will come"—the Dyersville, Iowa, baseball stadium receives more than 65,000 visitors annually.²⁸ This kind of off-shoot industry affects not only the film's set itself, but creates new customers for local hotels, restaurants, car rental services, and other travel- and tourism-related support services.

Due to the expansive market potential that a proliferating entertainment industry can secure, nearly forty states have enacted some kind of substantial incentive to attract productions to shoot within their borders.²⁹ These tax

²⁵ COMMONWEALTH OF MASS. DEP'T OF REVENUE, A REPORT ON THE MASS. FILM INDUSTRY TAX INCENTIVES 4 (Mar. 2008) (indicating that more than 2200 people in the state were employed by the twenty film productions in Massachusetts in 2006, for an average of 3.2 months). Figures for employment within ancillary businesses like hotels and restaurants are not included in the Department of Revenue report. *But see* Cieply, *supra* note 4, at A39 (The director of the Massachusetts Budget and Policy Center warns that these figures are deceptive, and that "[t]here's no evidence yet that this is a particularly efficient or effective way to create jobs.").

²⁶ Kimi Yoshino, *From Film to Destination Spot*, L.A. TIMES, June 5, 2006, at C1.

²⁷ *Id.* The U.S. Department of Commerce spent \$10.5 million on billboards in the U.K., urging Brits to visit the U.S. with this phrase: "You've seen the film, now visit the set." *Id.* These billboards touted an array of films, including *Thelma and Louise*, *Maid in Manhattan*, and *Sweet Home Alabama*. *Id.*

²⁸ *Id.*

²⁹ Cieply, *supra* note 4, at A26 (noting that a Hollywood consulting firm in Santa Monica, California, jokingly refers to the United States as "New Bulgaria," referencing a previous favorite low-cost destination for film shoots).

Initially, states instituted these tax incentives as a way to counteract the phenomenon of the "runaway production"—films that were leaving the United States to be shot in other countries (frequently Canada) that provided less expensive skilled labor, better tax incentives, stable production costs, and better exchange rates. In 1998, 27% of films released in the United States were produced abroad, resulting in a loss of \$10.3 billion to U.S. workers and the government. Pamela Conley Ulich & Lance Simmens, *Motion Picture Production: To Run or Stay Made in the U.S.A.*, 21 LOY. L.A. ENT. L. REV. 357, 358, 361–66 (2001). Starting with California's "Film California First" program, states began adopting the successful programs from other countries just to attract these productions back to the United States.

For a more in-depth discussion of international runaway productions, see generally Ulich & Simmens, *supra*.

incentives have also become a source of competition among the states; a race to be the lowest bidder at almost any cost to the state in the name of sparking local economic development.³⁰ It is a game of finance limbo: how low can these states afford to go, and more pointedly, how will they contort their systems to pass under the increasingly low bar?³¹

B. Lodging, Sales, and Use Tax Exemptions

One rudimentary incentive that states use to attract production companies is to provide exemptions or reduced rates for qualified productions on lodging, sales, and use taxes.³² To take advantage of these tax exemptions, a production must register with the state's film office in advance.³³ States differ in their approach for applying the tax exemption: some allow for an up-front exemption at the point of purchase, while others will offer a cash rebate upon a final audit of receipts.

Over the past years, several states have begun to impose a "transient lodging tax," or hotel tax, on temporary dwelling units, including hotels and motels, campgrounds, and vacation rental homes.³⁴ Oregon's state lodging

³⁰ Rifkin, *supra* note 18, at C5. The small businesses that depend on this industry in their home states are not blind to this. A casting agent in Boston noted, "[i]f [film producers] can get a 42 percent rebate in Michigan, they'll just pack up and find a way to make Michigan look like Paris." *Id.*

³¹ Because this Note examines tax incentives generally, it does not confront the potential constitutional violation of individual state tax plans discriminating against interstate commerce. *See* U.S. CONST. art. I, § 8, cl. 3. Although no state film incentive package has of yet been challenged on these grounds, state tax incentives in other industries have been previously tried. *See, e.g.,* New Energy Co. of Ind. v. Limbach, 486 U.S. 269 (1988) (energy); Bacchus Imps., Ltd. v. Dias, 468 U.S. 263 (1984) (alcohol); and Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) (finance). For a discussion of why the New Mexico Film Incentive Program would probably not violate the Constitution, see Danielle M. Cantrell, Comment, *New Mexico as Hollywood's Backlot: An Examination of Film Financing, State Tax Incentives, and Constitutional Limitations*, 37 N.M. L. REV. 533, 555–71 (2007).

³² *E.g.,* S.C. CODE ANN. § 12-62-30 (2008) (codifying South Carolina's full exemption for motion picture production companies from paying sales and use taxes); N.C. DEP'T OF REVENUE, SALES AND USE TAX TECHNICAL BULLETINS § 20-4 (Aug. 1, 2008) (on file with author) (reviewing North Carolina's policy of applying a 1% "privilege tax" in lieu of a full rate sales and use tax).

³³ *See* sources cited *supra* note 32. In most states, these incentives are subject to limitations that require a certain percentage of the film to be shot in the state or a minimum dollar amount to be spent in the state.

³⁴ Oregon passed its transient lodging tax in 2003, assigning this tax to any "dwelling unit . . . used for temporary overnight stays." OR. DEP'T OF REVENUE, STATE OF OR. LODGING TAX FREQUENTLY ASKED QUESTIONS (2006), <http://www.oregon.gov/>

tax, for instance, adds a 1% charge in addition to other state and local taxes, and is collected by the lodging provider and reported quarterly to the state.³⁵ This money is then used for state programs to “promote statewide tourism.”³⁶

The lodging tax exemption is one with important value, particularly for films with a large number of people involved with the production. Shooting a movie can take anywhere from a few weeks to a few years,³⁷ and during that time most cast and crew members need a place to stay. Several states offer a lodging tax exemption for stays that meet a minimum duration, typically thirty days.³⁸

It is unlikely that a lodging tax exemption alone would be enough to lure a film to any given state. Although this saving can be especially substantial in a state like Maine, where the lodging tax rate is 7%,³⁹ several other states that offer transferable tax credit programs incorporate the cost of lodging as a qualifying expense that may be included in the final audit.⁴⁰ Further, lodging accounts for such a small part of a film’s budget that a lodging tax break would be considered more of a deal-sweetener than a deal-breaker.

An exemption on sales tax, on the other hand, may have a substantial effect on the film production’s budget. Although sales tax is a crucial fundraiser for the states,⁴¹ a waiver of this sales tax may have the effect of spurring more spending, which directly benefits the local economy. Further, sales tax has a broader reach than lodging tax: forty-five states impose a sales tax (or a local-option sales tax), and these taxes affect nearly every aspect of

DOR/BUS/docs/604-401.pdf. To assist taxpayers, the state released a pamphlet of frequently asked questions. *See id.*

³⁵ OR. REV. STAT. § 320.305 (2007).

³⁶ OR. DEP’T OF REVENUE, *supra* note 34.

³⁷ *See generally* RALPH S. SINGLETON, *FILM SCHEDULING, OR, HOW LONG WILL IT TAKE TO SHOOT YOUR MOVIE?* (2d ed. 1991).

³⁸ *See, e.g.*, ARIZ. REV. STAT. ANN. § 41-1517(V)(4) (2009); IDAHO CODE ANN. § 63-3622TT (2008). These exemptions are not usually created exclusively for the film industry; the exemption typically applies to *any* stay longer than thirty days. *See, e.g.*, OR. REV. STAT. § 320.308(6) (establishing an implied tenancy for a stay of more than thirty consecutive days).

³⁹ The Maine Department of Revenue website currently lumps its lodging tax in with general sales tax. Maine Revenue Services, Sales/Use & Service Provider Tax, <http://www.maine.gov/REVENUE/salesuse/homepage.html> (last visited Jan. 9, 2009).

⁴⁰ Transferable tax credit initiatives will be discussed *infra* Part II.C.

⁴¹ William F. Fox, *Importance of the Sales Tax in the 21st Century*, in *THE SALES TAX IN THE 21ST CENTURY 2* (Matthew N. Murray & William F. Fox eds., 1997). On average, the state sales tax provides 33% of state revenues, positioning it as the biggest source of income for the state. *Id.*

public consumption, including retail for durable goods, nondurable goods, services, and transportation.⁴² Most state sales tax rates are below 6%.⁴³

State sales tax exemptions are applied broadly from state to state, allowing the filmmaker to save big on any number of purchases related to the production. New Jersey's exemption provides expansive relief from its 7% sales tax on virtually anything that has been purchased or rented in connection with (and not incidental to) a film production, including personal property, tools and materials, and services.⁴⁴ The Georgia Film Office provides a brochure that lists a non-exhaustive collection of twenty-seven different materials or services that qualify for its tax exemption including camera equipment, motion picture film, sound recording equipment, specific effects supplies and equipment, animation equipment, and film processing services.⁴⁵ The brochure also makes clear what types of purchases do not fall under its very broad exemption: hotel rooms and lodging, catering services, make-up, transportation services, crew uniforms, and communication devices.⁴⁶

Since film production companies are always working on a budget,⁴⁷ the sales tax exemption is an attractive way to get more out of each dollar by effectively lowering the price at the point of purchase. The broad nature of the sales tax exemption encourages the production company to buy or rent large expenditures (particularly filming equipment) locally, putting more money back into local businesses, if not directly into the state's pockets.⁴⁸

Even if a filmmaker attempts to purchase goods tax-free in one state and bring them into a different state for production, the states counter-balance this move with a use tax. Use (or consumption) tax is a fee placed on a good

⁴² *Id.* at 6–7. Most states exempt items deemed “necessities” (food purchases, prescription drugs, and education) from sales tax. DAVID BRUNORI, STATE TAX POLICY: A POLITICAL PERSPECTIVE 83 (2001).

⁴³ BRUNORI, *supra* note 42, at 69.

⁴⁴ N.J. STAT. ANN. §§ 54:32B-3, 54:32B-8.49 (2008).

⁴⁵ GA. FILM, VIDEO & MUSIC OFFICE, SALES & USE TAX INCENTIVE 3 (on file with author).

⁴⁶ *Id.* In 2008, Georgia enacted the Georgia Entertainment Industry Investment Act, a 30% tax credit for qualifying pictures, that may include some costs not recoverable under the sales tax exemption. GA. CODE ANN. § 48-7-40.26 (2009) (noting that “production expenditures” may include wardrobe, cost of lodging, and airfare, among other things).

⁴⁷ See *supra* note 17 and accompanying text.

⁴⁸ See Steve Peoples, *Reviews for State's Film Tax Credit Aren't Good*, PROVIDENCE J., Aug. 12, 2008, at B1 (indicating that only 7% of exempt spending makes its way back to the state through income tax or increased spending). This Note will expand on this investment in Part IV, *infra*.

for the privilege of using, storing, or consuming the property or services within a state.⁴⁹ Use tax is intended to have the deterring effect of placing out-of-state goods on a level playing field with goods that would be subject to sales tax within the state, a disincentive for consumers to circumvent a state's sales tax system.⁵⁰

Taking into consideration the purchases involved in the production of a motion picture, it is no wonder that the use tax could play a large role in budgeting.⁵¹ In a state where the use tax would be effective, a good deal on the rental of cameras, lighting equipment, sound crews, or editing services from an out-of-state vendor would be subjected to a tax rate equivalent to the local sales tax, applied on top of any sales tax already paid at the time of purchase in the originating state of purchase.

The use tax exemption appears to provide a best-of-both-worlds situation for the filmmaker: he is able to shop outside the jurisdiction to find the best value for the rental and purchase of necessary equipment, but then may transport it into the production state with no additional tax liability. Without any kind of minimum spending requirement within the production state, the purpose of the use tax exemption—to encourage spending in local businesses—may in fact result in a production company spreading the wealth among many states, taking advantage of the best prices available elsewhere and importing them with no use tax obligation.⁵²

Exemptions on lodging, sales, and use tax offer substantial and oftentimes immediate benefits to the film production. Procedurally, the states with tax exemption programs have very few hurdles to jump through: most states have placed their application for a certificate of exemption on the

⁴⁹ 85 C.J.S. *Taxation* § 1992 (2008). In order for property to be subject to use tax, it must be tangible, purchased at retail without prior payment of state sales tax, and used or consumed within the state.

⁵⁰ *Id.* The Supreme Court has held that use tax does not infringe on the federal right to regulate interstate commerce. *See* *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 346 (1954).

⁵¹ Each state's film office offers information on local rental services. However, most filmmakers will have to negotiate rates for equipment rental directly with the provider. The author of this Note is not an expert filmmaker, but a quick search found that a daily rental for a single handheld camera can range anywhere between \$200–\$5000 per day. *See, e.g.,* Du-All Camera, <http://www.duallcamera.com/catalog/index.shtml> (offering rentals for cameras ranging in quality and price).

⁵² The Supreme Court requires that a retailer have a physical presence in a state before it can be obligated to collect the state's use tax. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). Several states have adopted legislation that obligates out-of-state retailers to waive this "nexus" protection. *See, e.g.,* CAL. REV. & TAX. CODE § 6203(c)(4)(B).

state's film office website.⁵³ Despite their ease of use and obvious appeal, these broad tax exemptions may hinder some of the state's goals and can inadvertently create loopholes that are easily exposed by a production company.⁵⁴

C. Tax Rebates and Transferable Tax Credits

As much as the tax exemptions appear to offer a broad discount on any number of items that a film production company might require, several states have taken action to further market their locations as the ideal spot for filming by creating comprehensive plans that work as a flat-rate rebate program or an actual investment opportunity for the state. Currently, more than half of the states offer a tax rebate program either in addition to or in lieu of sales and use tax exemptions.⁵⁵ These programs have modeled themselves after the foreign jurisdictions like Canada that were successful at enticing American productions out of the United States in the first place.⁵⁶ With these state tax credit programs, the term "runaway production" no longer refers solely to a film produced in another country.⁵⁷

A 2008 article in *P3 Update*, an industry magazine devoted to film and television production, listed the top ten places to shoot in the United States, taking into consideration a number of factors, including tax incentives and skill level of local crews.⁵⁸ Like with other state tax exemption rules, the

⁵³ The Georgia Department of Revenue form is a standard, one-page document. STATE OF GA. DEP'T OF REVENUE, APPLICATION FOR CERTIFICATE OF EXEMPTION PRODUCTION EQUIPMENT OR SERVICES FOR FILM PRODUCERS OR FILM PRODUCTION COMPANIES, https://etax.dor.ga.gov/salestax/st3forms/TSD_Sales_Tax_Production_Equipment_Exemption_Application_STPE1.pdf (last visited Feb. 11, 2010).

⁵⁴ These shortcomings include a failure to generate revenue for the state and the ability for several purchases to be made in foreign jurisdictions, discussed *infra* Part IV.

⁵⁵ Foderaro, *supra* note 8, at B5.

⁵⁶ Ulich & Simmens, *supra* note 29, at 369.

⁵⁷ Jason Deparis, *Top 10 Places to Shoot in the U.S.*, P3 UPDATE, July 2006, at 19–20. (indicating that the previous understanding of the phrase "runaway production" implied a foreign element, but now, "[t]he United States and its territories have . . . become Hollywood's 'backlot.'").

⁵⁸ Frank Barron & Margie Barron, *Top 10 Places to Shoot in the U.S.*, P3 UPDATE, July 9, 2008, <http://p3update.com/top-stories/location/top-10-places-to-shoot-in-the-us.html>. In no particular order, the article highlighted the following states: (1) New York; (2) Connecticut; (3) Massachusetts; (4) Louisiana; (5) New Mexico; (6) Arizona; (7) Pennsylvania; (8) Florida; (9) Illinois; and (10) Michigan. *Id.* Not surprisingly, the authors explicitly cited the "current economic climate" as a driving factor in the importance of production location selection. *Id.* "[S]tates that offer the best incentives,

kinds of costs that may be included in the tax credit vary from state to state.⁵⁹ However, this Note will address the following programs that seem to have garnered extraordinary attention, for better or worse: New York, New Mexico, and Louisiana.

1. *New York: Big Incentives in the Big Apple*

What would *Sex and the City* be without *the City*? For many films and television shows, the Big Apple provides more than just an iconic skyline that frames a production; the City becomes an additional character.⁶⁰ However, although New York has always been a major player in the entertainment industry with several media outlets located in Manhattan, filming a regular series or an entire film on location in New York has become too expensive over time due to rising production costs, generally, and, specifically, because other states have begun to provide incentives that have been too good to refuse.⁶¹

Fearful of the growing competition in surrounding states and in response to the loss of an estimated \$750 million from the New York economy,⁶² the New York state legislature developed the New York State Film Production Tax Credit program to enhance the existing 10% film incentive rebate.⁶³ The new program tripled the tax credit to 30% on below-the-line expenses for

along with support facilities and services, plus impressive crews, are getting a boost from filmmakers taking notice of how much money they can save. *That's changing the way the industry does business.*" *Id.* (emphasis added).

⁵⁹ *Id.*; see also Foderaro, *supra* note 8, at B5 (distinguishing "below the line" costs—typically those incurred during production like crew wages, wardrobe, and catering—from "above the line" costs, which include preproduction work like script development and wages for the director and most actors).

⁶⁰ Stuart Elliott, *A New York Job Behind Every Light and Camera*, N.Y. TIMES, Dec. 22, 2008, at 4A, available at <http://www.nytimes.com/2008/12/22/business/media/22Adnews1.html> ("New York can be anything . . . It could be the backdrop to a movie and it can fade and let you do your thing, or it can be the central character.").

⁶¹ Foderaro, *supra* note 8, at B1 (pointing out that New York's then-10% discount was dwarfed by surrounding states like Connecticut, whose tax incentive program offered a 30% tax credit, resulting in a steep drop in applications to the New York State film office).

⁶² Matea Gold & Richard Verrier, *Escape to New York*, L.A. TIMES, June 3, 2008, at E1.

⁶³ Press Release, David Paterson, Governor, State of New York, Governor Paterson Signs Bill Expanding Tax Credit for New York State Film Production (Apr. 23, 2008), available at http://www.state.ny.us/governor/press/press_0423081.html.

qualified productions.⁶⁴ Further, the state has increased its allocated budget for funding eligible film productions each year: in 2008, the state allotted \$60 million to the program, with increases nearly every year until 2013.⁶⁵ In order for a project⁶⁶ to be eligible for the program, its studio work—any filming taking place in a closed production facility, either a set or soundstage—must be at a qualified facility within New York State.⁶⁷

In order for a production to become eligible to be awarded a tax credit, it must complete a multi-part application process.⁶⁸ First, the applying production company must fill out the Initial Application, which consists of a form detailing basic information about the project and its production team; a full-scale project budget; a summary of projected budget costs (separating the costs as either qualified or not qualified); and an anticipated shooting schedule.⁶⁹ The Initial Application must be submitted at least ten days before principal photography commences, but no more than 180 days prior to the start of when principal photography is scheduled to begin.⁷⁰ Once the application has been submitted to the Office of Motion Picture Development, the applicant must schedule an interview with the Office to review the application in person. A producer and at least one other member of the managing production team must be present at the interview.⁷¹

⁶⁴ Gold & Verrier, *supra* note 62, at E1.

⁶⁵ The New York State Governor's Office for Motion Picture and Television Development has created a NY Loves Film website to explain the tax incentives to potential filmmakers. New York State Film Production Credit, <http://www.nylovesfilm.com/tax/> (last visited Jan. 10, 2009) [hereinafter NY Loves Film]. In 2010, the state set aside \$85 million for qualifying film projects under this program and will increase the set-aside to \$90 million per year in 2011 and 2012 and \$110 million in 2013. Paterson, *supra* note 63.

⁶⁶ Eligible productions include feature films, episodic television series, television pilots, or a television movie or miniseries. *Id.*

⁶⁷ *Id.* If a production shoots at multiple locations, at least 75% of the total facility costs must be spent at the qualified facility. *Id.* The incentive package will also cover on-location shooting (scenes shot outside the studio or soundstage), provided that either 75% of the on-location shooting days are in New York State, or that the production spend at least \$3 million on work incurred at the qualified facility. *Id.*

⁶⁸ See GOVERNOR'S OFFICE FOR MOTION PICTURE & TV DEV., INSTRUCTIONS FOR INITIAL APPLICATION PACKET PROVIDED BY THE NEW YORK STATE, available at <http://www.nylovesfilm.com/tax/Instructions2009.pdf> [hereinafter NY Instructions].

⁶⁹ This initial application is called, conveniently, "Form A," which can be downloaded at http://www.nylovesfilm.com/tax/FORM_A.pdf. All of the relevant forms are available on the NY Loves Film website, *supra* note 65.

⁷⁰ NY Instructions, *supra* note 68, at 4.

⁷¹ *Id.* at 15.

Following the interview, the Office will either issue an approval, accompanied by a certificate of conditional eligibility, or it will reject the application. However, the issuance of a certificate of conditional eligibility provides no guarantees: the state is not locked into any fixed amount of tax credit for the production—the amount of the credit is determined only after production.⁷² Following approval, the production must notify the Office of the date on which principal photography begins on the film, updating several of the forms that were submitted with the Initial Application to reflect any changes in the interim.

No more than sixty days after the completion of post-production on the film, the producer is required to submit the Final Application.⁷³ This is the most intensive step because it contains the documents upon which a final tax credit amount will be determined by the state. The Final Application consists of several parts: a final budget, a payroll report, a cast and crew list, a production shooting schedule, daily production reports, and any other documents requested by the Office.⁷⁴ After review from the state, a tax credit is awarded to the production in the amount of 30% of qualified costs or an amount that does not push the state over its annual cap.⁷⁵ The credits are awarded on a first come, first served basis.⁷⁶

The tax credit is characterized as a refundable tax credit that the applicant may apply to his New York State tax return for the year in which production was completed.⁷⁷ The credit for each expense is a figure equal to 30% of the full amount of the purchase, not just the amount paid in taxes for the goods or services.⁷⁸ In other words, if a production were to spend \$1000 on catering services (\$800 in actual service fees and \$200 in state sales tax, for instance), the production's tax credit amount would be \$300 (30% of the purchase). This purchase would be charted along with any other qualifying purchases that had already accumulated by that point. The tax credit is then submitted with the applicant's state tax return for the year the film was

⁷² *Id.* Although provisionally granted the full percentage credit, the credit funds are subject to availability of the tax credit caps at the state level. *Id.* Typically, however, this amount is settled upon an accounting of all expenses pursuant to the Final Application, and the expectation of both the producers and the Film Office is an accommodation of the 30% tax credit, based on preliminary figures in the Initial Application. *Id.*

⁷³ See Final Application, available at http://www.nylovesfilm.com/tax/FORM_D.pdf (last visited Feb. 12, 2009).

⁷⁴ *Id.*

⁷⁵ NY Loves Film, *supra* note 65.

⁷⁶ NY Instructions, *supra* note 68, at 14.

⁷⁷ NY Loves Film, *supra* note 65.

⁷⁸ *Id.*

completed, and if the amount of the credit earned is greater than its state tax liability, 100% of that overage is refunded to the applicant.⁷⁹

Announcing the legislation,⁸⁰ Governor David Paterson noted, “The entertainment industry plays an important role in fostering economic growth by promoting our state on movie and television screens across the world, and creating thousands of jobs for New Yorkers.”⁸¹ His remarks, however, could be an understatement. The New York film industry, bolstered in particular by New York City’s studio offerings, one-of-a-kind city streets and park locations, and a highly skilled labor force, plays a major role in the state economy. In fact, more than 100,000 people in New York City alone are employed in the entertainment industry, contributing over \$5 billion to the City’s local economy.⁸²

In addition to the New York State Film Production Tax Credit program, New York City had already instituted a film incentive program called “Made in NY.” Signed into law by Mayor Michael Bloomberg in 2005, the Made in NY program works much like the statewide program,⁸³ but adds an extra 5% tax credit for any qualifying film project that shoots at least 75% of its production in any of the five boroughs of New York City.⁸⁴ In addition to the 5% tax credit, the Made in NY program provides a marketing credit, which allows a qualifying production and an additional 1% credit for outdoor media

⁷⁹ *Id.*

⁸⁰ Codified at N.Y. TAX LAW § 24 (McKinney 2008). The New York State program was not immune to legislative skepticism. *See* Dade Hayes, *States Trying to Sweeten Pic Pot*, VARIETY, Apr. 10, 2008 at 1, 20, available at <http://www.variety.com/article/VR1117983879.html?categoryid=13&cs=1> (quoting a film executive saying, “[l]awmakers were looking to cut \$800 million out of the budget. They look at tax credits as an expense. So we [film executives] had to expend a lot of effort to explain how they actually help bring revenue to the state.”).

⁸¹ Peter Kiefer, *Paterson Expands Breaks on Taxes for Film Companies*, N.Y. SUN, Apr. 24, 2008, at 3.

⁸² Press Release, City of N.Y. Mayor’s Office of Film, Theatre & Broad., New York City Thanks Residents for Supporting Local Film and Television Production in New PSA Campaign (Dec. 9, 2008), available at http://www.nyc.gov/html/film/html/news/010109_psa_campaign_launch.shtml.

⁸³ In fact, the New York State Film Production Tax Credit and the Made in NY incentive applications have been combined into a single common application for any New York City-based projects.

⁸⁴ Press Release, City of New York Mayor’s Office of Film, Theatre & Broad., Mayor Signs Film and TV Tax Credit into Law (Jan. 4, 2005) (on file with author) (Upset with losing productions to Canada, Bloomberg stated, “[T]his law will help return New York City to prominence as a location for film and television production, ensuring that films that are set in New York City are actually shot there.”). New York’s five boroughs include Manhattan, Brooklyn, Queens, Bronx, and Staten Island.

advertisements, including posters on bus shelters.⁸⁵ As part of the marketing credit, the program provides a production with a Cultural Benefit allowance, equal to 0.1% of the project's overall budget, which encourages the production to make a donation to a not-for-profit cultural institution, with the intention of supporting local arts institutions to educate and fortify the "city's creative community."⁸⁶

Along with the tax incentives provided by the Made in NY program, productions are given a Made in NY discount card, which entitles productions to discounts and special offers when presented to participating vendors.⁸⁷ Finally, as an added bonus, the program offers an extended concierge service, intended to facilitate special needs for the production, whether through scouting assistance, expedited access to New York City property or facilities, or preparation for the premiers and launches.⁸⁸ In short, the Made in NY program entices productions not just through tax breaks, but also through value-added services that make the city a more attractive and ultimately more affordable location to shoot.

As a result of the expanded New York State Film Production Tax Credit program and the Made in NY initiative, many shows have returned to the Big Apple for production. In a much-publicized move, the New York-based series *Ugly Betty*, which shot its first two seasons on a soundstage in Hollywood, moved production to New York for its third season, in large part due to the tax rebates.⁸⁹ Additionally, once the tax incentive was announced,

⁸⁵ The website for the City of New York Mayor's Office of Film, Theatre, and Broadcasting provides several photographic examples of qualifying advertisements. NYC.gov—Mayor's Office of Film, Theatre & Broadcasting—Production News, http://www.nyc.gov/html/film/html/news/marketing_examples.shtml (last visited Apr. 10, 2010).

⁸⁶ NYC.gov—Mayor's Office of Film, Theatre and Broadcasting—Film Grants, http://www.nyc.gov/html/film/html/incentives/made_ny_incentive.shtml (last visited Apr. 10, 2010).

⁸⁷ *Id.* More than 850 vendors throughout New York City provide a Made in NY discount, comprising an array of services from hotel, car rental, and airline travel to dry cleaning, catering, storage, messenger, and banking services. *Id.*

⁸⁸ *Id.*

⁸⁹ Donna Freydkin, 'Betty' Loves New York; Move Adds Energy to Show's Third Year, USA TODAY, Sept. 23, 2008, at D1 (According to the show's executive producer, Silvio Horta, "[w]e shot the pilot [in New York City], and I always wanted to shoot the show in New York, but it was too expensive.").

In a related incentive for the film industry, the New York Loves Film program offers an Investment Tax Credit for qualified film production facilities. The New York State Governor's Office for Motion Picture & TV Development provides a description of the program, available at <http://www.nylovesfilm.com/pdf/InvestmentTaxCredit.pdf>. This credit encourages private investment in film production facilities by assigning corporate taxpayers and sole proprietors a tax credit ranging between 4%–5% of the investment

a number of shows on the 2008–2009 line-up announced that they, too, would be shot in New York.⁹⁰

Furthermore, these tax programs appear to have ushered in the kind of financial success that both the New York State Film Production Tax Credit and Made in NY initiatives sought to achieve. In its first two years alone, the Made in NY program brought in \$2.4 billion in new business to New York.⁹¹ Bolstered with the adoption of the additional 30% state tax credit, New York is playing host to more filming than ever before.⁹² Whether or not this increase in production will have a ripple effect back into the state's economy remains to be seen.⁹³

2. New Mexico: From Tumbleweeds to Tamalewood

In 2002, fresh off the election of Bill Richardson as governor, the state of New Mexico implemented an aggressive tax plan to recruit productions to shoot in the state.⁹⁴ Fueled by a recurring budget surplus and a state constitution that requires a balanced budget,⁹⁵ New Mexico has been able to

credit base applied toward the development and construction of a qualified film production facility. *Id.* Although this initiative does not directly decrease the filmmaker's costs, it does illustrate the state's effort to assist in developing a sustaining entertainment and production industry within the state. *Id.*

⁹⁰ Gold & Verrier, *supra* note 62, at E4. In a victory over international runaway productions, the New York program lured the Fox show *Fringe* from Toronto, where it had planned on shooting. *Id.*

⁹¹ Press Release, City of New York Mayor's Office of Film, Theatre and Broadcasting, NYC Lands Record Number of Pilots (Feb. 14, 2007) (on file with author).

⁹² In New York City's November 2008 jobs report, the motion picture industry was one of the few bright spots, having added 800 jobs, thanks to the influx of new programming being filmed in New York. See Valerie Block, *Film, TV Shows Produce Jobs*, CRAIN'S N.Y. BUSINESS, Jan. 4, 2009, at 6 (adding that in November 2008, eighteen television programs—each accounting for 1000–2800 jobs—were shooting in the city, as well as twenty movies).

⁹³ Skeptics remain critical of the tax package, likening the credits to a “cash gift” by the state. See Kiefer, *supra* note 81, at 3. In fact, it was reported in February 2009 that the state of New York had run through its entire \$515 million budget that it had set aside to fund the program through 2013. Matea Gold, *N.Y. Tax Credit Program That Lured Film and TV Shoots Runs Out of Funds*, L.A. TIMES, Feb. 6, 2009, at C2. In response, Governor David Paterson included a \$132 million extension of the program in his 2009 budget for the state of New York. Dave Itzkoff, *New York Extends Tax Credit for Film and TV Productions*, N.Y. TIMES, Apr. 3, 2009, at C2.

⁹⁴ Richard Verrier, *New Mexico Film Industry Hopes to Steal the Show*, L.A. TIMES, Apr. 2, 2007, at A1.

⁹⁵ Simon Romero, *Coming Soon to a Screen Near You: New Mexico*, N.Y. TIMES, Jan. 26, 2004, at C6 (noting that the film fund receives its money through the Severance

utilize its diverse terrain and its eager workforce to transform into what locals have dubbed “Tamalewood,” or alternatively, “Hollywood’s Newest Home.”⁹⁶ Already, the state has attracted Hollywood juggernauts like Steven Spielberg’s *Indiana Jones and the Kingdom of the Crystal Skull*, the film adaptation of *Transformers*, and the 2007 Academy Award-winning best picture *No Country for Old Men*, directed by Joel and Ethan Coen.⁹⁷

New Mexico provides a unique study in the development of a sustainable film industry; when Governor Bill Richardson described the state’s efforts, he noted, “Our main objective is to become a supportive satellite of Hollywood. We don’t want to be greedy with this, but for a state with low per capita income, it’s a way for us to attract a clean, environmentally friendly industry that leaves a positive impact.”⁹⁸ This industry, however, is not predicated on entertaining the one-and-done Hollywood shots that other states have become familiar with; New Mexico has laid the foundation for a turnkey production services infrastructure, and has developed a system of attractive incentives to sweeten the deal for the producers.⁹⁹ The strategy has worked: due to the film incentive program, New Mexico has experienced a \$1.8 billion impact directly from entertainment-related spending.¹⁰⁰

The mantra for the New Mexico film industry is: investment, investment, investment. Unlike the New York plan, which is heavy on refundable tax

Tax Permanent Fund, which is financed by royalties from natural gas, oil, coal, and timber extraction). These funds are a steady source of income for the state, particularly when energy prices are at record highs. See Michael Cieply, *This Film Will Be Back, Strike or No Strike*, N.Y. TIMES, July 2, 2008, at E1.

⁹⁶ Verrier, *supra* note 94, at A1.

⁹⁷ The New Mexico Film Office has compiled a comprehensive list of television series and movies that have been shot in the state. See New Mexico Film Office, *New Mexico Filmography*, <http://nmfilm.com/filming/filmography/> (last visited Feb. 14, 2009).

⁹⁸ Romero, *supra* note 95, at C6. In a January 2009 report by Ernst & Young, New Mexico recognizes that the economy is impacted through three different channels: (1) increased film production activity; (2) increased investment in New Mexico film studios and equipment; and (3) spending by tourists who visit New Mexico or extend their trip to see film-related attractions. New Mexico State Film Office and State Investment Council, *Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit* (Jan. 2009) (on file with author). These economic impact channels are further subdivided into three types of impact: direct (employment, income, or sales associated with the activities); indirect (the purchase of goods and services that occur as a result of the direct impacts); and induced (ancillary consumer spending that results from the wages paid to workers of film productions). *Id.*

⁹⁹ Verrier, *supra* note 94, at A10 (As an industry insider reveals, “[New Mexico is] one of the few states that’s actually trying to build an industry and not just bring in projects on a one-time basis.”).

¹⁰⁰ Cieply, *supra* note 95, at E10.

credits that are figured only after production is complete,¹⁰¹ New Mexico has developed a system that puts money into the film at the front end through no-interest loans.¹⁰² In addition, New Mexico has invested in its internal film infrastructure—dedicating similar no-interest loans (and assistance with real estate) to producers like Lions Gate Entertainment to build production centers¹⁰³—and in the training and development of film professionals in the state.¹⁰⁴

Under the Severance Tax Bonding Act (STBA), the New Mexico State Investment Officer, working closely with the New Mexico Film Office, may provide a \$15 million no-interest loan to a project that (1) is filmed wholly or substantially in New Mexico; (2) has entered into a distribution contract with a reputable distribution company; (3) employs a crew consisting of mostly New Mexico residents; (4) has posted a completion bond approved by the New Mexico Film Office; and (5) has obtained a guarantee of repayment of the amount invested by the state.¹⁰⁵

As authorized under the STBA, the New Mexico Film Investment Loan Program reaffirms that up to \$15 million in no-interest loans may be made to any given film production with a budget of at least \$2 million.¹⁰⁶ The Loan Program, organized through a joint effort of the New Mexico Film Office and the State Investment Council, lists several key requirements: a guarantor for the principal amount of the loan must be in place; the script must meet certain eligibility requirements (limiting excessive or gratuitous violence or sexual content, severe language, drug abuse, culturally sensitive material, or a combination of these); 85% of the principal and second unit photography

¹⁰¹ See Part II.C.1.

¹⁰² Romero, *supra* note 95, at C6. The State Investment Office has been granted state statutory authority to invest in films produced in the state of New Mexico. See N.M. STAT. ANN. 1978 § 7-27-5.26 (2008).

¹⁰³ Verrier, *supra* note 94, at A10.

¹⁰⁴ Through the Film Crew Advancement Program, New Mexico offers a 50% reimbursement for on-the-job training of New Mexico residents in certain crew positions. New Mexico Film Office, Film Crew Advancement, <http://nmfilm.com/filming/incentives/film-crew-advancement.php> (last visited Feb. 14, 2009).

¹⁰⁵ N.M. STAT. ANN. 1978 § 7-27-5.26 (2008).

¹⁰⁶ New Mexico Film Office, Investment Program, <http://nmfilm.com/filming/incentives/investment-program.php> (last visited Feb. 14, 2009) [hereinafter NMFO Investment Program]. The loan amount can be up to 100% of the production cost, but may not exceed \$15 million total. *Id.* The loans are repayable in two to five years. CTR. FOR ENTMT'T INDUS. DATA & RESEARCH, THE GLOBAL SUCCESS OF PRODUCTION TAX INCENTIVES AND THE MIGRATION OF FEATURE FILM PRODUCTIONS FROM THE U.S. TO THE WORLD: YEAR 2005 PRODUCTION REPORT 65 (2006) [hereinafter CEIDR REPORT].

must occur within the state; and a minimum of 60% below-the-line payroll must consist of New Mexico residents.¹⁰⁷

Once the threshold requirements have been met and the Film Office has approved the script, the production must work with the IATSE Local 480 (the film production union) to determine whether crew members will be available to fulfill the below-the-line payroll requirements.¹⁰⁸ After a distribution agreement is settled and the package is complete, the state Film Advisor schedules two hearings that require attendance by the producers: one in front of the Private Equity Investment Advisory Committee, and the second in front of the State Investment Council.¹⁰⁹

Because the state is providing a no-interest loan through a traditional (if not typical in the film industry) investment opportunity, the approval process is front-loaded with business forecasting of financial viability. The state agrees to take “an appropriate piece of the post-breakeven revenues in lieu of interest,” thus providing a safeguard on direct terms for which slice of the pie the state will receive in remittance of its loan.¹¹⁰ Adding a final layer of protection for New Mexico, the loan is negotiated with the State Investment Council, which requires the producer to complete proper due diligence, and funds are not available until the loan has been closed to the satisfaction of the state.¹¹¹

Despite providing up-front funding for the project through a no-interest loan, the New Mexico Film Office also has established a 25% tax refund that behaves similarly to the New York plan’s tax credit.¹¹² This credit is applied to the full amount of the expenditure, such that if a film were to spend \$1 million on qualified expenses pursuant to the rules established by the New Mexico Film Office, the production would receive a tax credit of \$250,000 to be applied to the production’s income tax return for the state of New Mexico.

Much like the requirements set out for the Loan Program, the New Mexico Film Office sets out similar guidelines in order for the refund to be

¹⁰⁷ N.M. STATE INV. COUNCIL, FILM INVESTMENT PROGRAM PARTICIPATION LOAN POLICY 2–4, Sept. 27, 2007, available at http://www.sic.state.nm.us/PDF%20files/FILM_INVESTMENT_PROGRAM_LOAN_%20POLICY_92707_FINAL.pdf [hereinafter NM INCENTIVES].

¹⁰⁸ NMFO Investment Program, *supra* note 106.

¹⁰⁹ NM INCENTIVES, *supra* note 107, at 5.

¹¹⁰ NMFO Investment Program, *supra* note 106. Throughout this entire process, the state explicitly points out, “[c]ommercial viability is the most significant factor that the SIC will examine.” *Id.*

¹¹¹ *Id.* For more information on the New Mexico State Investment Council and its role in the Film Loan Investment Program, see New Mexico Film Investments, <http://www.sic.state.nm.us/film.htm> (last visited Feb. 14, 2009).

¹¹² NM INCENTIVES, *supra* note 107, at 2.

approved.¹¹³ The state also expects that all in-state obligations are paid and that the parties enter into a binding contract spelling out the terms of the rebate program.¹¹⁴ The tax rebate applies to several different kinds of expenditures, including wages for New Mexican workers,¹¹⁵ construction, equipment rental, costuming expenses, facility costs, craft services, lodging, most transportation, and filming insurance.¹¹⁶ To be certain, “the tax rebate applies only to expenditures that are subject to taxation in New Mexico.”¹¹⁷

Finally, New Mexico offers Nontaxable Transaction Certificates (NTTCs), which are redeemable at the point-of-sale and exempts the purchase from gross receipts (sales) tax.¹¹⁸ In an effort to ensure that incentives do not overlap, the NTTCs may not be used coincidentally with purchases qualifying for the 25% Tax Rebate.¹¹⁹ Since the Tax Rebate tends to have a more generous effect on purchases, the NTTCs are used mostly with the filming of commercials and public service announcements.

Through the efforts of the New Mexico Film Office and its incentive programs, the state has established a film industry that is both generous and “enormously successful.”¹²⁰ In its first two years, New Mexico had gone from hosting no films to landing production of twenty-five projects, resulting in more than \$200 million in new revenue.¹²¹ By jumping into the incentives game early, New Mexico has created an industry responsible for more than 1300 skilled jobs and annual economic impact in excess of \$400 million.¹²²

¹¹³ See NMFO Investment Program, *supra* note 106; see also *supra* note 106 and accompanying text. Many of the guidelines remain the same for any of the incentives offered by the New Mexico Film Office. *Id.*

¹¹⁴ NM INCENTIVES, *supra* note 107, at 2.

¹¹⁵ “Workers” here refers to any number of roles in the production, including on-screen talent, production specialists, set carpenters, on-site managers, office assistance, and other pertinent labor. New Mexico Film Office, Crew and Vendors, <http://nmfilm.com/filming/crew-resources/category.php?divid=1> (last visited Apr. 11, 2010).

¹¹⁶ NM INCENTIVES, *supra* note 107, at 5–6.

¹¹⁷ *Id.* at 5. Note that out-of-state *performers* (which is limited to actors and stunt performers) may qualify as long as the performers will pay New Mexico income tax.

¹¹⁸ New Mexico Film Office, No Sales Tax, <http://www.nmfilm.com/filming/incentives/no-sales-tax.php> (last visited Jan. 31, 2010).

¹¹⁹ *Id.*

¹²⁰ CEIDR REPORT, *supra* note 106, at 65–66.

¹²¹ *Id.* at 74.

¹²² Verrier, *supra* note 94, at A10. The article quotes then-Governor Bill Richardson on New Mexico’s success: “We had a very simple strategy Get ahead of every other state in terms of incentives, throw the kitchen sink at accommodating film companies—tax rebates, loans from the state, free state land, write-offs It’s created hundreds of

The effort has worked: Tamalewood is poised to stay in the spotlight as a go-to location for filming.

3. Louisiana: Pelican State Corruption and Cut-Backs

Louisiana has a knack for drawing in big films and big stars: *Ray*, which won Jamie Foxx an Oscar for best actor, was shot there; so was *Runaway Jury* (starring John Cusack, Dustin Hoffman, Gene Hackman, and Rachel Weisz).¹²³ And in 2007, Louisiana was host to its largest motion picture yet: *The Curious Case of Benjamin Button*, starring Brad Pitt and Oscar-winners Cate Blanchett and Tilda Swinton, shot on a budget of \$167 million.¹²⁴ Louisiana had also earned the distinction of granting the highest dollar credits, which provided a percentage tax credit for not just below-the-line expenses, but also above-the-line costs, including the salaries of the stars. For instance, the taxpayers of Louisiana were responsible for \$27 million in tax credits to the makers of *Benjamin Button*, a total equal to more than 16% of the film's entire budget.¹²⁵

In 2002, Louisiana was one of the first states to provide a tax incentive program for films, and at the time it was considered to be especially aggressive.¹²⁶ Under that plan, qualifying productions were eligible for transferable tax credits of up to 15% of the total production cost.¹²⁷ Additionally, Louisiana offered productions another 20% in tax credits for in-state payroll costs, as well as state sales tax exemption.¹²⁸ In its first two years, the state experienced an astounding 2850% growth in its entertainment production industry, with economic impact increasing more than 500%.¹²⁹

jobs." *Id.* Further indication of New Mexico's expanding role in the filming game is the increased number of scripts received by the New Mexico Film Office each year: The director of the film office says, "We used to get 10 scripts a year . . . Last year we got 250 scripts." *Id.*

¹²³ Stewart Yerton, *The Price of Fame*, TIMES-PICAYUNE (New Orleans), Feb. 27, 2005.

¹²⁴ Cieply, *supra* note 4, at A26.

¹²⁵ *Id.*

¹²⁶ CEIDR REPORT, *supra* note 106, at 63.

¹²⁷ *Id.* The transferable tax credits are unlike those offered by New York and New Mexico, for instance. Transferable tax credits "are similar to cash: They are transferable, so producers typically sell them to Louisiana businesses and residents with tax liabilities for a slightly reduced price, perhaps 80 cents on the dollar." Russell, *supra* note 3. The pros and cons of transferable tax credits will be discussed *infra*.

¹²⁸ CEIDR REPORT, *supra* note 106, at 63.

¹²⁹ *Id.*; see also Josh Spector, *Louisiana Tax Incentives Get \$100 Million Results*, HOLLYWOOD REPORTER, Oct. 1, 2003, at 17 (noting that the impact on the state economy had jumped from roughly \$20 million per year to over \$100 million).

By 2005, state taxpayers began to complain of the plan's excessive generosity, arguing that the huge payouts failed to result in any benefit to the taxpayers.¹³⁰ Adding further insult, the film office, which oversees most of the distribution of the incentives, had come under fire for fostering an alleged culture of corruption. Stemming from an investigation into Louisiana's film office, federal prosecutors charged Mark Smith, then film commissioner, with accepting nearly \$60,000 in bribes "to help inflate tax credits meant to lure movie production to the state."¹³¹ Several other prominent players, who were particularly active in developing Louisiana into the number three movie-making center in the United States, have also entered guilty pleas in response to charges of bribing the film office.¹³² The Louisiana film office scandal prompted U.S. Attorney Jim Letten to state, "It's painted a picture for us—a 3D picture—of how a small number of individuals can corrupt a large and very important industry."¹³³

In response to the public outcry surrounding the film office, the Louisiana legislature amended the tax credit rules, particularly those that recognized out-of-state expenditures.¹³⁴ The revised plan provides for two different types of tax incentives: an investor tax credit and a labor tax

¹³⁰ Russell, *supra* note 3, at A8. Among the complaints, state taxpayers felt it was unreasonable that their tax dollars were contributing 15% of the salaries of the top stars of the films, who typically were not even residents of the state of Louisiana.

¹³¹ Michael Kunzelman, *Ex-Louisiana Film Chief Pleads Guilty*, WASH. POST, Sept. 7, 2007, available at http://www.washingtonpost.com/wp-dyn/content/article/2007/09/07/AR2007090701283_pf.html. Smith pled guilty to the charges and was sentenced to two years in prison. Laura Maggi, *Former Louisiana Film Official Gets Two-Year Sentence in Bribery Case*, TIMES-PICAYUNE (New Orleans), July 29, 2009, at A1.

¹³² In December 2008, Malcolm Petal, a New Orleans-based lawyer and CEO of Louisiana Institute of Film and Technology (LIFT), pleaded guilty to one charge of conspiracy to bribe the film office. Gordon Russell, *Guilty Plea Filed in Movie-Bribe Case; Hammond Lawyer Helped Carry Out Deal*, TIMES-PICAYUNE (New Orleans), Mar. 6, 2009, at B1. Petal reportedly paid out \$135,000 to Smith and an intermediary to receive inflated tax credits, reportedly leading to \$41.4 million in Louisiana tax credits on production expenditures totaling \$242.8 million. *Id.* Petal was eventually sentenced to five years in prison for his role and agreed, as part of his plea, to pay \$1.35 million in restitution to the state of Louisiana. Laura Maggi, *Film Executive Malcom Petal Sentenced to 5 Years for Bribing State Official*, TIMES-PICAYUNE (New Orleans), Apr. 23, 2009, available at http://www.nola.com/news/index.ssf/2009/04/film_executive_sentenced_for_b.html.

¹³³ *Id.* For background on the investigation of LIFT, see Robert Travis Scott, *FBI Raids Film Offices as Tax Probe Widens: Fed Investigates Possible Abuse of Incentives*, TIMES-PICAYUNE (New Orleans), June 2, 2007, at A1.

¹³⁴ Russell, *supra* note 132, at B2.

credit.¹³⁵ Further, the sales tax exemption's January 1, 2007 sunset provision was bumped up a full year and, consequently, the film office no longer recognized the sales tax exemption after January 1, 2006.¹³⁶

Louisiana currently offers productions a 30% transferable tax credit on all in-state qualified expenses.¹³⁷ The language of the statute and the amended policy emphasize the film office must take a strict interpretation of "in-state" expenditures, defining the phrase "expended in the state" to include "services procured and performed in the state."¹³⁸ In order to qualify for the tax credit, the production company (or individuals acting on behalf of the production) must have a base investment of no less than \$300,000.¹³⁹

The investor tax credits are particularly valuable in Louisiana because they are transferable. That means that the owner of the tax credit may sell it to another party—oftentimes just an average taxpayer—to claim on his or her personal tax returns.¹⁴⁰ Film production companies like to do this because it enables them to earn cash quickly in a state where they likely would not have serious tax consequences. Once the project is completed and the total amount of tax credits is assessed, the studio will sell its credits to a broker for little more than fifty cents on the dollar, and the broker will then turn around and sell them to individual taxpayers at a slight mark-up.¹⁴¹ The individual who purchases the tax credit, typically for face value starting at \$10,000, will

¹³⁵ Louisiana Film & Television, <http://www.louisianaentertainment.gov/film/content.cfm?id=61> (last visited Mar. 5, 2009); see also Matthew Ross, *American Rebates Bloom*, VARIETY, May 18, 2008, at 51.

¹³⁶ Revenue Info. Bulletin No. 06-011: Expiration Date of Sales Tax Exemption For Motion Picture Production Companies Changed From January 1, 2007, to January 1, 2006, State of La. Dep't of Revenue (Feb. 15, 2006) (on file with author).

¹³⁷ LA. REV. STAT. ANN. § 47:6007(C)(1)(b)(i) (2009). The motion picture investor tax credit is codified at § 47:6007.

¹³⁸ *Id.* § 47:6007(B)(3). The film office's website explains further, noting that some services like film processing may have a physical corporate presence in Louisiana, but if the actual service is not rendered in Louisiana, that service will no longer qualify as an in-state expenditure. Louisiana Film & Television, <http://www.louisianaentertainment.gov/film/content.cfm?new=1633&id=64> (last visited Mar. 4, 2009).

¹³⁹ H.B. 936, 2007 Reg. Sess. (La. 2007), available at <http://www.legis.state.la.us/billdata/streamdocument.asp?did=450325>. For the full language of House Bill 936, see *id.*

¹⁴⁰ Dorothy Pomerantz, *Tinseltown Tax*, FORBES, Mar. 27, 2006, at 93.

¹⁴¹ *Id.* at 94. These tax credits, as Pomerantz overtly suggests, are appealing to legislators because "they don't look like the bald-faced subsidy that they, in fact, are," and likens transferable tax credits to "a clever backdoor way to put cash in the glamorous guests' pockets." *Id.*

instead apply the credit to his or her personal income tax returns, lightening his or her tax burden and sometimes benefiting from a refund as a result.¹⁴²

In addition to the 30% transferable tax credit, Louisiana has adopted a labor tax credit that entitles a studio to an additional 5% if Louisiana residents are hired in connection with the project, whether as crew members or other film-related labor.¹⁴³ In effect, the studio may take this exemption for any member of the payroll who is a Louisiana taxpayer, whether a member of the cast, crew, or other person in the production team. In order to rein in this additional credit, however, the revised rules state that if the payroll of any individual exceeds \$1 million, the added 5% does not apply to that person's salary.¹⁴⁴

The Louisiana film industry has been very successful under its investment credit program and has survived a major scandal in the film office. With several neighboring states vying to take a piece of Louisiana's place in the industry,¹⁴⁵ the Louisiana legislature is again faced with the question of whether its plan is too aggressive or, in light of increased competition, not aggressive enough. However, despite the state's \$2 billion deficit, the film industry seems to be a bright spot, generating upwards of \$763 million in economic input in 2007.¹⁴⁶ And with sunset provisions decreasing the tax credit in 2010 and 2012,¹⁴⁷ it seems that Louisiana must decide between taking a risk on increased tax credits or otherwise being left behind by the states with more generous film tax incentives.

¹⁴² *Id.* The article gives a good example: assume a taxpayer buys a \$100,000 credit for \$75,000. If the taxpayer had \$100,000 in tax liability in the state, it is wiped out for \$25,000 less than anticipated. Further, the amount paid for the state tax credit can potentially be deducted from federal returns, although this does provide for a realization of \$25,000 of income. *Id.* The Internal Revenue Service has allowed this kind of deduction because of the adoption of the American Jobs Creation Act of 2004, which permits investors to deduct 100% of their investment, including the purchase of tax credits. I.R.C. § 181 (2006).

¹⁴³ Louisiana Film Incentive & Tax Credit Program Information, http://www.fbtfilm.com/film_incentives.aspx (last visited Jan. 31, 2010); see also Louisiana Film & Television, <http://www.louisianaentertainment.gov/film/content.cfm?id=61> (last visited Jan. 31, 2010).

¹⁴⁴ *Id.*

¹⁴⁵ See Alexandyr Kent, *Louisiana May Look to Solidify, Strengthen Film Incentives*, SHREVEPORT TIMES, Mar. 8, 2009, at 6A (noting that Georgia, behind its 30% tax credit program, has quadrupled its number of feature films shooting in the state, and that Texas is poised to push through a \$60 million incentives fund in 2009).

¹⁴⁶ *Id.* In 2007, Louisiana granted \$105 million in tax credits, less than seven times the economic impact generated by the productions.

¹⁴⁷ Under the current scheme, the credit drops on July 1, 2010, to 20%, and then to 15% on July 1, 2012. *Id.*

III. INVESTING IN A LUXURY INDUSTRY IN A *SLUMDOG* ECONOMY

During a time of economic instability, any investment will invariably be closely scrutinized. Despite its illusion as a luxurious, romantic risk, the film industry has historically been as close to a sure bet as any, providing viewers with a comparably inexpensive escape from the turmoil outside the multiplex.¹⁴⁸ However, with the advent of the Internet and other technology making the media accessible at the click of a button, industry experts wonder if this recession may be different.¹⁴⁹ This Part will first consider the early indications that the box office is stronger than ever, remaining a reliable investment for state tax dollars, and will follow with a brief look at how states that do not currently have tax incentive programs are responding.

A. *The Great Escape: Strong Performance at the Box Office*

During the Great Depression, Americans found their escape at the movie theaters.¹⁵⁰ In what was considered the beginning of the “Golden Age of Hollywood,” Americans flocked to the movies to see epics like *Gone with the Wind*, fantasies like *The Wizard of Oz*, and virtually anything starring a little girl named Shirley Temple.¹⁵¹ With ticket prices averaging twenty-seven cents and many theaters offering door prizes and other incentives to lure audiences, the movies were wildly popular during the Depression.¹⁵²

¹⁴⁸ See, e.g., Cieply & Barnes, *supra* note 12, at A1 (quoting a mother of four, who was purchasing tickets to see *Jonas Brothers: The 3D Concert Experience* because “[s]pending hundreds of dollars to take them to Disneyland is ridiculous right now”); Chmielewski & James, *supra* note 6, at A1 (describing the box office as traditionally being “recession proof”).

¹⁴⁹ Chmielewski & James, *supra* note 6, at A17.

¹⁵⁰ In the 1930s, as much as 65% of the American population attended movies on a weekly basis; by the 1960s, this percentage dropped (and remained) around 10%. Michelle Pautz, *The Decline in Average Weekly Cinema Attendance: 1930–2000*, 11 ISSUES IN POL. ECON. (2002), available at <http://org.elon.edu/ipe/pautz2.pdf>. For an overview of movie-going trends of Americans since the 1930s, see generally *id.*

¹⁵¹ Barry Koltzow, *Hollywood and the Next Great Depression*, ORANGE COUNTY REG., Oct. 9, 2008, available at <http://www.ocregister.com/entertainment/movies-114766-depression-people.html> (offering his own advice to Hollywood, encouraging fewer musicals, more screwball comedies, and a remake of *The Grapes of Wrath*).

¹⁵² Lisa Girion, *The Big Screen Gives Big Comfort*, L.A. TIMES, Feb. 2, 2009, at C2. Although this article indicates that attendance dipped during the Great Depression, other sources suggest that attendance was at its all-time high. Compare Press Release, Univ. of Md. Newsdesk, More TV/Radio Use Likely During Financial Crisis: UM Media Economist (Oct. 10, 2008), available at <http://www.newsdesk.umd.edu/sociss/release.cfm?ArticleID=1754> (quoting media economist Douglas Gomery stating, “[o]ne great myth is that film-going did well during the Great Depression of the 1930s Not

Given the success of the film industry even during the Depression, many have called the box office “recession-proof.”¹⁵³

However, economists and media scholars have been quick to point out that film executives should be wary this time around. Inexpensive entertainment is much more accessible in today’s marketplace considering the broad reach and relative affordability of cable television, a commodity not available during the Great Depression.¹⁵⁴ Additionally, the proliferation of the Internet and online capabilities has supplanted even cable television and represents a level of access to entertainment never before known in times of economic hardship.¹⁵⁵

Despite these fears, the box office has once again shown its resiliency in times of economic hardship. In the first month of 2009, the box office brought in an unprecedented \$1.03 billion, nearly 19% over the January 2008 receipts.¹⁵⁶ Although increased ticket prices have had some impact, overall attendance has also increased by nearly 16%.¹⁵⁷ These figures amount to the largest box office surge in more than twenty years.¹⁵⁸ As one industry insider stated, “People always complain about the price of movie tickets Yet at

so, attendance had fallen by one-third in 1935.”), with JOEL W. FINLER, *THE HOLLYWOOD STORY* 244 (2003) (stating that during the 1930s, a higher percentage of the population went to movies each week than when the United States experienced economic expansion and prosperity).

¹⁵³ To illustrate this point, figures show that cinema attendance has increased during five of the last seven recessions. See Chmielewski & James, *supra* note 6, at A17.

¹⁵⁴ See Press Release, Univ. of Md. Newsdesk, *supra* note 152 (noting that television is “where [Americans] can see movies and other entertainment,” encouraging people to stay home rather than head to the movie theaters).

¹⁵⁵ Movies can now be downloaded for “rental” from services like Apple’s iTunes Store for as little as \$0.99. In addition, certain websites like Hulu (<http://www.hulu.com>) are rendering television unnecessary, providing streaming next-day full episodes of programs ranging from *30 Rock* to *Damages* at no charge. See Chmielewski & James, *supra* note 6, at A17 (“The endless stream of free content, through legitimate services as well as pirate sites, appears to be shifting viewing habits more quickly than industry executives had anticipated—or intended.”).

¹⁵⁶ Girion, *supra* note 152, at C1. The author makes a note to point out that these figures include box office receipts alone, and do not take into consideration the amount made through concessions. However, the January 2009 statistics are staggering: despite an average ticket price of \$7.29 (up \$0.11 from one year ago), 141 million tickets were sold, up 16% from 121 million tickets sold during the same month one year ago. *Id.*

¹⁵⁷ Cieply & Barnes, *supra* note 12, at A1.

¹⁵⁸ *Id.*

a time when people are hyper-aware of what they are spending, they don't seem to be having any trouble going to the movies."¹⁵⁹

The kinds of movies people are going to also say a lot about what kind of entertainment people are seeking. The highest grossing films in the first two months of 2009 did not include any of the critically hailed best picture nominees, which were announced in late January 2009.¹⁶⁰ Instead, the highest grossing pictures included mostly comedies, action/adventure thrillers, and horror films—the same kinds of films that were especially successful during the 1920s and 1930s.¹⁶¹ Considered to be review-proof, these top performing films illustrate a departure from serious dramas. Studios are releasing “movies that are happier, scarier or just less depressing than what came before.”¹⁶²

The film studios, which employ more than 200,000 people in Los Angeles alone and pump an estimated \$20–30 billion to that local economy, have also taken proactive steps to cope with economic hardship.¹⁶³ Partially to stave off resorting to rounds of layoffs, studios are cutting back the number of movies they are making, reducing marketing and production costs, and trimming travel expenses.¹⁶⁴ Many studios are using the recession as a tool to reevaluate the way they have previously done business.¹⁶⁵

¹⁵⁹ Girion, *supra* note 152, at C1 (quoting Paul Dergarabedian, president of Media by Numbers, an agency that, according to its own website, provides “reliable box-office data.” See www.mediabynumbers.com).

¹⁶⁰ In fairness, each of the five best picture nominees for 2009—*The Curious Case of Benjamin Button*, *Frost/Nixon*, *Milk*, *The Reader*, and *Slumdog Millionaire*—opened before the end of 2008. In spite of that, only *Benjamin Button* even cracked \$100 million total at the box office. See Pamela McClintock, *Can Oscar Change Its Game? . . . As Studios Face B.O. Anomalies*, VARIETY, Feb. 6–15, 2009, available at http://www.variety.com/awardcentral_article/VR1117999731.html?nav=news&categoryid=1982&cs=1 (noting that the 2009 best picture contenders did not see the “hefty box office bump” that nominees typically enjoy).

¹⁶¹ Through February 2009, the following films were the top ten grossing pictures: (1) *Paul Blart: Mall Cop*; (2) *Taken*; (3) *He's Just Not That Into You*; (4) *Hotel for Dogs*; (5) *Tyler Perry's Madea Goes to Jail*; (6) *Coraline*; (7) *Friday the 13th*; (8) *Bride Wars*; (9) *My Bloody Valentine 3-D*; and (10) *Underworld: Rise of the Lycans*. Meet In the Lobby, <http://www.meetinthelobby.com/2009-box-office-update.html> (last visited Mar. 10, 2009).

¹⁶² Cieply & Barnes, *supra* note 12, at A18.

¹⁶³ Eller & Verrier, *supra* note 7, at A1.

¹⁶⁴ *Id.* at A14.

¹⁶⁵ The CEO of Lions Gate Entertainment said, “[i]t’s a great wake-up call to ask ourselves if we’re operating as smartly and strategically as we can . . . Times like this force us to reexamine our operating plans, look at where we’re spending money and where we’re getting returns.” *Id.*

Although Hollywood is not entirely immune from a bad economy, its place in the market appears to be safe for now. With 2009 off to a record-setting pace for both box office revenue and attendance, studio executives might be able to release a brief sigh of relief. However, as the studios continue to cut back costs, the pressure from Hollywood continues to mount against state legislatures to offer increasingly generous incentives to lure the productions that continue through the recession.

B. The Good, the Bad, the Ugly: States Renewing, Retooling, and Rejecting Incentives

In response to that pressure, and taking into consideration present economic realities, several state legislatures—both those with existing tax incentive packages and those that have not yet adopted any kind of incentive for the film industry—are looking for ways to mitigate those interests.¹⁶⁶ While certain states face pressure from taxpayers to rethink and cut back on their film spending, other states are introducing comprehensive legislation intended to build or expand the local film industry. On the other hand, some states are flatly rejecting any push to create a film tax program.

Michigan is one such state feeling pressure from every angle to amend its tax incentive program. The Michigan program is one of the most recently adopted, but its numbers are staggering: it provides up to a 42% tax credit, by far the largest in the United States.¹⁶⁷ And for a state known primarily for its

¹⁶⁶ Several of the pressures that the state legislatures face have been discussed above, but include bordering states increasing their own tax incentive programs for the film industry, complaints from taxpayers, and general financial hardship. The discussion of Louisiana's tax incentive program, *supra* Part II.C.3, is an example where all three (plus impropriety in the administration of the film office) played a factor in the state's decision to amend its tax package.

¹⁶⁷ Chris Christoff, *Movie Industry Rebates Too Rich?: Key Lawmakers: '09 Payout May Hit \$100 Million*, DETROIT FREE PRESS, May 29, 2008, at A3; see also Bashirah Muttalib, *Michigan Strengthens Film Incentives*, VARIETY, Mar. 18, 2008, available at <http://www.variety.com/article/VR1117982647.html?categoryid=8&cs=1>.

The Michigan tax program is structured similarly to other programs discussed in Part II.C, *supra*. In order to qualify for a 40% tax credit, a film production must spend at least \$50,000 in Michigan. The production may receive an additional 2% credit if it shoots in one of the "103 Core Communities." There is a \$2 million salary cap per employee per production, but the Michigan Film Office makes a point to stress that there is no other cap and no sunset. See Michigan Film Office—Michigan Filming Incentives Application, <http://www.michigan.gov/filmoffice/0,1607,7-248--168008--,00.html> (last visited Mar. 14, 2009).

automobile industry, its efforts to build an entertainment industry have been met with mixed reviews.¹⁶⁸

From the beginning, the Michigan plan has had its critics.¹⁶⁹ But recently, more and more have challenged the benefits of the tax credits.¹⁷⁰ Michigan state legislators and members of the senate finance committee are pressing for Janet Lockwood, director of the film office, to testify, perhaps a sign that the Michigan plan will soon be retooled.¹⁷¹

Other states are taking notice of the red flags raised in the Michigan plan. After House Bill 196 passed in Ohio, which would have granted \$100 million in 25% transferable tax credits to qualifying productions in the state, Governor Ted Strickland made use of his veto power for the first time since he took office in 2007 to reject the tax incentive.¹⁷² The state Republicans continued to place the film tax credit high on their agenda,¹⁷³ and finally in

¹⁶⁸ Christoff, *supra* note 167, at A3 (“[T]he key to creating a Michigan film industry is having thousands of full-time production people,” which at this point consists mainly of people who have worked on commercials for automobiles in Detroit.); *see also* Peter Sanders, *Michigan Sees Itself in the Movies*, WALL ST. J., Feb. 3, 2009, at B2 (The article quotes chairman and chief executive of Motown Motion Picture Studios Linden Nelson: “People were coming in from other states and Canada to film once the new incentives kicked in But it really wasn’t creating the jobs and the infrastructure here in Michigan.”).

¹⁶⁹ Initially, state senator Nancy Cassis was the only Michigan legislator to vote against the credit; shortly after passing the credit, other legislators began to rethink their decision and called for immediate reform. Press Release, Nancy Cassis, Senator, Mich., Michigan Film Credit Offers Little Hope of Reward, Penalizes Small Businesses (June 12, 2008), available at <http://www.senate.michigan.gov/gop/readarticle.asp?id=1549&District=15> (making the argument that the tax credits do not pay for themselves and will cost the state more than \$110 million annually).

¹⁷⁰ Christopher Behnan, *Officials Not Sold on Film Tax Incentive*, LIVINGSTON DAILY, Mar. 4, 2009, available at <http://www.livingstondaily.com/apps/pbcs.dll/article?AID=/20090304/NEWS01/903040309> (questioning the validity a Michigan Film Office report for 2008 that failed to acknowledge how much each individual film was granted in tax credits). One Michigan insider, skeptical of the number and types of jobs created through the Michigan program, stated, “[i]t’s *Wizard of Oz* stuff here, and it’s time to pull back the curtain.” *Id.*

¹⁷¹ *Id.*

¹⁷² Aaron Marshall, *Filmers Tax Break to be Vetoed*, PLAIN DEALER (Cleveland), Dec. 19, 2008, at A1, A12 (indicating that Strickland was particularly concerned that the tax credit was freely transferable from company to company, which he called “fiscally irresponsible”).

¹⁷³ Fact Sheet, Ohio Republican Party, Senate Republicans’ Priority Bills for the 128th General Assembly (2009), available at <http://www.gongwer-oh.com/128/Sengopbills.pdf>.

July 2009, the Ohio legislature passed a 25% refundable tax credit program, budgeting up to \$30 million for projects to shoot in 2010–11.¹⁷⁴

And while other states like Alabama are having trouble even getting their tax incentive bills heard in the legislature, tax credits are on the way in the place where film in America began: California. With the help of a movie-star-turned-governor, California is embracing the current economy as the best time to increase cash flow into the state by instituting a tax credit program.¹⁷⁵

The idea that California would be one of the last to create some kind of tax incentive seems mind-boggling—after all, California is the place where more people are employed in the entertainment industry than any other place in the United States.¹⁷⁶ And although California has managed to keep the cameras rolling because of the industry-held belief that “the crews and resources are unmatched,”¹⁷⁷ competition from states providing hefty tax credits has resulted in productions packing up and leaving the Hollywood sound stages, leading to a noticeable drop in the California filming schedule and, not incidentally, a noticeable drop in production-related revenue.¹⁷⁸

In February 2009, in the face of a \$42 billion budget gap, the California state legislature approved a tax credit program as part of the state’s budget.¹⁷⁹ Passed with the goal of reclaiming a number of jobs that have been lost to runaway productions, the California plan is relatively modest when compared to other states: capped at \$100 million in total credits annually, the plan would give a 20% credit for below-the-line costs for

¹⁷⁴ Tim Feran, *Tax Credit Draws Film Crews, Jobs to Ohio*, COLUMBUS DISPATCH, Jan. 6, 2010, at 8A. The Ohio Motion Picture Tax Credit has been codified at OHIO REV. CODE ANN. § 122.85 (2010).

¹⁷⁵ Michael Cieply, *California Beckons Film Crews*, N.Y. TIMES, Feb. 17, 2009, at C1. The proposed tax credit comes at a perfect time, when legislators are able to justify the credits “in the face of planned increases in the sales tax and other levies.” *Id.* at C6.

¹⁷⁶ See *supra* note 163 and accompanying text.

¹⁷⁷ Cieply, *supra* note 175, at C6.

¹⁷⁸ In 1996, California’s film office had scheduled 4059 days of location shooting in Los Angeles alone per quarter. In the fourth quarter of 2008, that number dropped to just 1051. *Id.* at C1 (The author of the article quips, “[m]ovies can still be a pretty good business [in California]. When you can find one.”); see also Richard Verrier, *Tax Relief OKd for Film, TV Shoots*, L.A. TIMES, Feb. 20, 2009, at C1 (quoting the president of the filming permits office saying, “[s]o much has disappeared, anything we bring back will be a boon.”); Carl DiOrio, *Movie Industry Gets a Break in California Budget*, REUTERS, Feb. 20, 2009, available at <http://uk.reuters.com/article/idUKTRE51J15K20090220> (figuring that for every \$100 spent on production in California, there is a return of \$285 in economic output).

¹⁷⁹ DiOrio, *supra* note 178.

production up to \$75 million, or 25% for any independent film feature.¹⁸⁰ The California plan would also provide a 25% tax credit to any television series that relocates to California after shooting somewhere else—a somewhat “ugly” move to try and woo *Betty* back from New York.¹⁸¹

While California’s incentives are less generous than the tax credits in Michigan and New Mexico, California offers something that no other state can yet lay claim to: the added value of the most experienced crews and the most comprehensive film infrastructure in the country. Though some detractors argue that the tax credits will not be big enough to lure productions back to Hollywood,¹⁸² California seems poised to reestablish itself as the filming capital of the United States.¹⁸³

The current activity and debate among states rethinking their tax incentives signal that now may be the time to become more creative with the way tax programs have been developed in the past. When it unveiled its plan, New Mexico’s film office developed something that had never been done before. In the current economic climate, states may have to take a cue from New Mexico and think outside the box.

IV. RETHINKING INCENTIVES: *FROST/NIX* THE REBATES

Since their inception, state tax incentive plans have offered a mixed bag of success and cause for concern. Without question, the filmmakers who receive tax incentives are the winners when a state exempts the production from certain types of taxes or provides credits, which in effect subsidize a portion of the film’s budget.¹⁸⁴ If the films are not bringing in the jobs and economic stimulus that the tax incentives were intended to encourage,

¹⁸⁰ Dave McNary & Sam Thielman, *Taxing Situation for New York*, VARIETY, Feb. 19, 2009, available at <http://www.variety.com/article/VR1118000377.html?categoryid=1236&cs=1>.

¹⁸¹ *Id.* This provision has led some commentators to refer to the legislation as the “*Ugly Betty* Bill,” arguing that it was passed as a direct result of California losing the series to New York. Lauren Horwitch, *Calif. OKs \$500M Tax Credit for Hollywood*, THE WRAP, Feb. 19, 2009, available at <http://www.thewrap.com/article/1473>; see also *supra* Part II.C.1 of this Note for a discussion of the New York tax credit program that attracted *Ugly Betty* to leave its California sound stage after two seasons to begin shooting in New York.

¹⁸² Verrier, *supra* note 178, at C2 (quoting a drafter of the New Mexico plan saying, “[i]t’s hard to understand how [California’s tax credits are] going to be competitive with states that actually have incentives where the credits are much higher.”).

¹⁸³ The California plan should shave approximately 13% off the budget of a \$2.5 million TV series, which one studio executives says should be “enough to make us competitive.” *Id.*

¹⁸⁴ See *supra* Part III for a full discussion on these points.

however, states must begin to rethink whether investing in the film industry is the best use of taxpayer dollars.

Each state's legislative body should look at the effects of its current plan and determine whether it is working. States like New Mexico and New York, which have found a lot of success and have developed a strong local film industry, should not change what their legislatures have successfully enacted. If these states' current budgets do not allow for the plan to continue as strongly as in the past, the states' legislatures should retain the basic structure of their programs while utilizing cost-saving measures—such as a decreasing the amount set aside for the year—until it is financially viable to increase the amount. It seems crucial to retain a quality incentive program; the quantity that can be doled out is likely more flexible.

In the states, such as Michigan, that have not seen much success, however, the legislatures must decide if they are really making a smart, long-term investment or if they are simply star-struck. These states must think critically about whether or not a viable, long-lasting film industry is really a possibility for the state, and moreover, whether or not now is the time to attempt to build the infrastructure for an otherwise untested filming market. The ultimate question is whether or not the state is better off because of their efforts in creating this new industry. Although a few of these tax credit programs have created a successful influx of entertainment-related revenue in states not known for their filming infrastructure, other states are losing too much money with no redeeming income going back to the state.

One place to start is by looking to economic development policies and employing something similar to a Tax Increment Financing (TIF) program. TIF is a system of financing for new public infrastructure, typically in a blighted area, that creates a special fund for the increased tax revenue derived from the improvements made on the property.¹⁸⁵ The TIF freezes the tax base for a specific number of years and allows all of the increased tax revenue to be placed in a fund specifically for the project.¹⁸⁶ The government dedicates tax increments within the district to finance debt issued to pay for the project: for instance, if a developer takes out a private loan to pay for the project, the TIF money is remitted to the developer to pay off the balance.¹⁸⁷ As one commentator points out, a TIF structure is an attractive way of funding urban redevelopment for two reasons: first, it provides an answer to the difficult search for creative financing mechanisms; and second, it satisfies

¹⁸⁵ Joyce Y. Man, *Introduction to TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACTS* 1, 1 (Craig L. Johnson & Joyce Y. Man eds., 2001).

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

the urge to develop revenue and expenditure systems that reflect the principles of public finance.¹⁸⁸

Although states that authorize TIF programs typically link the program to property taxes,¹⁸⁹ a similar kind of system might work in the film industry. Using principles from the New Mexico Film Investment Loan Program,¹⁹⁰ states might be able to assist in paying back the film's debt through tax revenue that is directly raised as a result of the film production's presence in the state. For instance, rather than give an exemption of sales and use tax entirely, the state would be able to dedicate the increased sales tax revenue to the project's debt.¹⁹¹ Further, the increased state income tax derived from jobs that are created through the production might be dedicated to the TIF as well. Rather than granting a percentage of the overall expenditures that the project makes in the state, the "refund" that the film studio would receive is directly tied to the amount of tax that was paid in the state.

This solution makes sense for a number of reasons. First, it gives the impression that the project is paying for itself. Here, money that is generated as a result of a film or television project goes back to the production, squaring away debt with state money that the project is responsible for initiating in the first place. It forms a metric by which a project's economic impact on a state is proportionate to the incentives the state gives back. There is a greater sense of real reciprocity here, and the state would not bear the burden of paying back refunds to a project that manages to accumulate a disproportionate tax credit.

Second, a TIF system for the entertainment industry would establish a feeling of increased legitimacy because it creates a channel through which the money travels to the state and then back into the film project. It creates a visible, individualized till from which the government is funding the project while still providing the incentive of putting all sales tax right back into the project. Additionally, it would decrease the amount of money being paid out for out-of-state expenditures, since it would be difficult for the film studio to get an out-of-state receipt through an auditor.

¹⁸⁸ J. Drew Klacik & Samuel Nunn, *A Primer on Tax Increment Financing*, in *TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACTS* 15, 15 (Craig L. Johnson & Joyce Y. Man eds., 2001).

¹⁸⁹ John L. Mikesell, *Nonproperty Tax Increment Programs for Economic Development: A Review of the Alternative Programs*, in *TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACTS* 57, 57 (Craig L. Johnson & Joyce Y. Man eds., 2001).

¹⁹⁰ See *supra* Part II.C.2.

¹⁹¹ See Mikesell, *supra* note 188, at 58 (indicating that sales tax TIF programs have been adopted for other industries in several states, including California and Louisiana).

Finally, this system would allow the production to seek out any kind of financing—private investment as well as potential state investment opportunities like the New Mexico Loan Program—and would not restrict the ways by which film productions typically raise money. It would allow for innovative financing agreements between the production and private investors, as well as between the film studio and the state itself. By creating a pool of money to pay off the film debt, the film studio may shop around for the best interest rates on loans, as well as alternative funding through public finance mechanisms.

The biggest issue with this system is that it may not do enough to discourage runaway productions from leaving the United States and filming in foreign jurisdictions with greater incentives. However, given the current state of the national economy (and, as a result, state and local economies), states must turn their focus on what will best benefit their constituents. With states looking for opportunities to tighten their budgets, the expansion of the film industry in non-traditional filming locations seems to be a reasonable place to start.

V. CONCLUSION: *READING THE WRITING ON THE WALL*

State tax incentives for the film industry have had a positive effect by reining in the loss of jobs and revenue to other countries by way of runaway productions. However, the measures often seem reactionary rather than balanced, leading too frequently to a windfall for the filmmakers. In order to sustain a thriving entertainment economy, state legislatures should consider a number of factors when crafting the appropriate tax credit system for their states. In the face of harsh economic times, states must first protect taxpayers' dollars before investing in a risky entertainment infrastructure.

The film industry has always been culturally important, helping to raise the spirits of Americans during the Great Depression and other times of economic hardship. The fact remains that Hollywood is not going anywhere; in times of financial crisis, the movies remind you that you can bet your bottom dollar that the sun will be out tomorrow. But when the bottom dollar balloons to \$27 million in *Benjamin Button's* pocket, even that eternally optimistic, red-haired orphan might contemplate cutting back the film studios' allowance.

