McGeorge Law Review

Volume 35 | Issue 4 Article 5

1-1-2004

Soft Money: The Weapon of Choice for the Runaway Productions

Christopher H. Lytton
Morgan Creek Productions, Inc.

Soft Money: The Weapon of Choice for the Runaway Productions

Christopher H. Lytton*

I. INTRODUCTION

When *Matrix Revolutions* opened in one night to the extraordinary figure of $43.1 million dollars worldwide, its success represented the culmination of a marketing and distribution juggernaut.[1] The film was unveiled to the world with the precision of a well executed military maneuver; "[t]he trilogy-capping action saga [was] launched in a synchronized, global-village-style opening at precisely the same hour in 80 countries and 107 territories. [Warner's] has booked 'Revolutions' into 3,502 North American theaters, manufacturing more than 8,000 domestic prints and more than 10,000 international prints."[2] These numbers mean that almost twenty-five percent of all the available 35,280 movie screens in the United States were showing the same movie.[3] With at least a few hundred million dollars spent on making the *Matrix* projects, not to mention the other "tent pole" films that have driven the box office to new records, it would seem that every gaffer, grip, and set decorator in Hollywood must be gainfully employed. However, there is a flaw in this theory: *Matrix Revolutions* was not filmed in Los Angeles nor was it even filmed in the United States.

For years the entertainment industry, labor unions, government officials and pundits of all stripes have struggled with the epidemic of runaway production. Runaway production is a hot button topic that divides along ideological lines, with those who blame overbearing unions and the Byzantine bureaucracy of local and state governments on one side, and greedy producers on the other. No matter your position along the great divide, this is no chimera; significant numbers of movies are now shot in foreign countries and other states like New Mexico and North Carolina. This exodus has been a consistent trend since the Great White North first introduced significant tax incentives for producers in 1989.[4] However,

---

* Christopher H. Lytton received a B.A. in history *cum laude* from U.C.L.A. and a J.D. from the Southern Methodist University of Law, where he was an editor of the *Computer Law Review & Technology Journal*, and a member of the Jessup International Moot Court Team. Mr. Lytton is an attorney with Morgan Creek Productions, Inc., where he works on production and finance matters.

1. *See* Don Groves & Dade Hayes, *Matrix Mints $43 Mil in Round-the-World Bow*, DAILY VARIETY, Nov. 6, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*) (discussing the synchronized opening of *Matrix Revolutions*).

2. Jonathan Ring & Cathy Dunkley, *Matrix Muscle*, DAILY VARIETY, Nov. 4, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

3. *See* MOTION PICTURE ASS'N U.S. ENTERTAINMENT INDUSTRY: 2002 MARKET STATISTICS 23 (2003), *available at* http://www.mpaa.org/useconomicreview/2002/2002_Economic_Review.pdf (copy on file with *McGeorge Law Review*).

4. According to statistics from the Canadian Audio-Visual Certification Office ("CAVCO") the volume of certified film production grew significantly in 1999-2000 (ninety-nine films certified as opposed to twenty-nine the previous year) and seventy-four films have been at present certified for the period 2000-2001. Cannes

as California's business climate continues to drive small businesses out of the state, the impact of runaways in real dollars is more significant than ever. While many hope that Arnold Schwarzenegger will be able to reinvigorate the California production industry, the results of such efforts are far from certain. With almost six billion direct production dollars spent worldwide in 2002, the production end of the entertainment business generated an estimated $42 billion in total spending. Naturally, spending in this amount is a boon to any local economy lucky enough to snare a production. However, significant revenues, jobs, and prestige have been lost in the United States due to runaways.[5] While one can argue the numbers and aggregate impact of runaways, it is injurious to the economy on the local, state, and national levels. According to the Center for Entertainment Industry Data and Research ("CEIDR"), "[t]he attraction of subsidized feature film production outside the United States has led to losses for the U.S. economy of $4.1 Billion and 25,000 jobs in the past four years."[6] Unfortunately for local workers, unless the star of the film requires a domestic production and is at the power level of now-Governor Schwarzenegger,[7] chances are most producers will attempt to benefit from overseas or simply out-of-state incentives.

Current runaway statistics notwithstanding, it is important to keep the issue in its historical context. While runaways have only recently become an issue of public discourse, it is not a new problem for the industry, as explained by Pamela Conley Urich and Lance Simmens in their recent article:

> In December 1957, the Hollywood American Federation of Labor ("AFL") Film Council, an organization of twenty-eight AFL-CIO unions, prepared a report entitled "Hollywood at the Crossroads: An Economic Study of the Motion Picture Industry." This report addressed runaway production and indicated that prior to 1949, there were an "insignificant" number of American-interest features made abroad. However, the report indicated a drastic increase in productions shot abroad between 1949 and 1957. At that time four major studios- Columbia Pictures, Inc. ("Columbia"), Twentieth-Century Fox, Inc. ("Fox"), Metro-Goldwyn-Mayer ("MGM") and United Artists, Inc. ("United Artists")—produced 314 films. Of these films, 159, or 50.6 percent, were shot outside the United States. It also revealed runaway films were shot primarily in the United Kingdom, Italy, Mexico, France and Germany. The report further identified factors that led producers to shoot abroad: 1) authentic locale;

Market Co., *Canada*, STATISTIQUE CANADA, *at* http://www.cannesmarket.com/information/stats/canada.html?langue=6002 (last visited May 15, 2004) (copy on file with the *McGeorge Law Review*).

5. Dave McNary, *Runaway Costs U.S. $4 Bil; 25,000 Jobs Also Lost in the Past Four Years*, DAILY VARIETY, May 30, 2002, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

6. *Id.*

7. Rumor had it that Schwarzenegger required *T3: Rise of the Machines* be shot locally.

> 2) lower labor costs; 3) blocked currencies; 4) tax advantages and 5) easy money and/or subsidies.[8]

Although the above seems to demonstrate that runaway productions may be somewhat cyclical in nature, there are major differences between the business in the in 1950s and today. The modern entertainment business is a global powerhouse and lost production dollars are now in the billions. While ideologues can argue philosophically about the causes of the runaways, the numbers show a black-and-white situation. In the aggregate, potential U.S. workers and the combined government entities lost an estimated $10.3 billion to runaway projects in 1998 alone.[9] Compounding the impact of the statistics is the fact that the entertainment industry is an extremely diverse employer, comparable to small-town government or a military base; therefore, the effect of lost productions on the surrounding communities and support industries are significant. From cooks to lawyers, carpenters to medical professionals, printers to flower shops - the production of a film or television show is a multifaceted effort.[10] It has been stated that total combined losses in the U.S. for 2002 could be as high as $16 billion.

That cities, counties, states, and even the federal government should be aggressively combating the runaway issue is evidenced by these statistics. The following data is from the Center for Entertainment Industry Data & Research ("CEIDR") study released in 2002 that surveyed films produced between 1998 and 2001:

> Worldwide production spending increased from $5.56 billion in 1998 to $5.6 billion in 2001;[11]
>
> United States feature spending declined 17% to $3.24 billion in 2001 from $3.93 billion in 1999;[12]
>
> U.S. films with budgets above $50 million dropped to $1.51 billion in 2001 from $2.3 billion in 1998;[13]
>
> Expenditures for features shot in Canada increased from $430 million in 1998 to $1.05 billion in 2001.[14]

---

8. Pamela Conley Ulich & Lance Simmens, *Motion Picture Production: To Run or Stay Made in the USA*, 21 LOY. L.A. ENT. L. REV. 357, 358-359 (2001) (citations omitted).

9. *Id.* at 366.

10. *See generally*, STEVEN BERNSTEIN, FILM PRODUCTION (2d. ed. 1994).

11. CEIDR, THE MIGRATION OF FEATURE FILM PRODUCTION FROM THE U.S. TO CANADA & BEYOND 2, *at* http://www.ceidr.org/y2k1report.pdf (last visited May 15, 2004) [hereinafter CEIDR] (copy on file with the *McGeorge Law Review*).

12. *Id.* at 1.

13. *Id.* at 4.

14. *Id.* at 3.

In today's marketplace, runaways are even more harmful than in the period cited, due to recession and consolidation in the industry. The current unemployment rate is the highest American's have seen in years.[15] While runaway production job losses in the entertainment sector pale in comparison to the hemorrhaging of jobs in the airline or manufacturing sectors, the combined job losses, in the industries that support productions, are consequential.[16] Further, with the health-care system in crisis and concerns over the solvency of Social Security, the loss of money contributions to the various unions' pension and health plans is also of consequence. Further, the consolidation of the studios and the convergence of television and film giants such as Universal and NBC make working in the field more competitive.

Despite the historical statistics, since the tragic aftermath of the attacks of September 11, 2001, world events have slowed the flood of runaway dollars that characterized the 1990s.[17] Such things as global terrorism, war against Iraq, and unrest in the Middle East and a less appealing exchange rate have made stars and executives less apt to jump on a plane to Morocco. Further, Canada's misguided, although short-lived effort to terminate its tax shelter helped to effectuate an increase in domestic production. However, history, and the economics of movie and television making indicate that, once a modicum of political stability returns, producers will follow the soft money and cheaper costs outside of California and even the USA. When analyzing U.S. production issues the appropriate case study is California—Southern California in particular. The Los Angeles area has always been and continues to be the dominant geopolitical player in the entertainment industry. Before looking specifically at Southern California, we will examine statewide issues.

II. THE CALIFORNIA LANDSCAPE

While the October revolution has installed an entertainment insider as the Governor of California, Schwarzenegger has a great deal of work ahead to assist the California entertainment economy. In the past, California has not done enough to secure its relationship with the entertainment business. Whether from a sense of entitlement or simply malaise, for over a decade Sacramento watched entertainment jobs and tax dollars exit the state. However, California has recently become more active in its efforts to save such jobs. One state organization that is

15. American City Bus. Journals, Inc., *U.S. Unemployment Rate Falls Slightly to 6.1 Percent*, BIZJOURNALS, Sept. 5, 2003, *at* http://louisville.bizjournals.com/louisville/stories/2003/09/01/daily37.html (copy on file with the *McGeorge Law Review*) (reporting figures released by the U.S. Bureau of Labor Statistics).

16. Bureau of Labor Statistics, *Employment Situation Summary* (May 2004), *available at* http://www.bls. gov/news.release/empsit.nr0.htm (stating that the unemployment rate was 6.1% in April 2004).

17. Dave McNary, *Return of the Runaways*, DAILY VARIETY, Feb. 16, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

positioned to advance statewide efforts is the California Film Commission ("CFC").

The CFC's mandate is essentially to keep production dollars in California. The commission has an advisory board of twenty-one members, appointed by the governor, Senate pro tem, and speaker of the assembly.[18] While these are political appointments, the CFC is not just a figurehead organization, as it has a strong mandate to keep productions local. The following is a partial list of programs and services instituted in California.

A. *Financial Incentives*

Film California First ("FCF") is a multimillion dollar incentive program that provides up to $300,000 per project in rebates to qualified production companies filming in California. The only incentive program of its kind, FCF reimburses the cost of public labor and greatly reduces location site fees when filming on public property.[19]

The State Theatrical Arts Resources Partnership ("STAR") is a unique program that offers filmmakers access to unused state properties (e.g., health facilities, vacant office structures, prisons) for a nominal fee or at no charge, thus helping production companies to substantially cut below-the-line expenses.[20]

B. *Tax Incentives*

"Most cities or counties that impose a local hotel tax have a tax exemption for occupancies in excess of thirty days."[21] Additionally, there is generally "no sales or use tax on production or postproduction services on motion pictures or TV films." Moreover, there is usually "no sales or use tax on services including writing, acting, directing, casting, and storyboarding." Finally, there is a "five percent sales tax exemption on the purchase or lease of post-production equipment for qualified persons."[22]

---

18. Commerce & Economic Development Program, *Welcome to California*, *at* http://commerce.ca.gov/state/ttca/ttca_navigation.jsp?path=California+Film+Commission (last visited May 15, 2004) [hereinafter *Welcome to California*] (copy on file with the *McGeorge Law Review*).

19. Press Release, Commerce & Economic Development Department Program, Governor Davis Signs Bill Expanding Successful "Film California First" Program (Sept. 23, 2002), *available at* http://commerce.ca.gov./state/ttca/ttca_navigation.jsp?path=Calfornia+Film+Commission (copy on file with the *McGeorge Law Review*); Press Release, Commerce & Economic Development Program, "Film California First" to Be Theme of California Pavilion at Locations Global Expo 2001 (Feb. 21, 2001), *available at* http://www.commerce.ca.gov/state/ttca/ttca_navigation.jsp?path=California+Film+Commission (copy on file with the *McGeorge Law Review*).

20. *Welcome to California*, *supra* note 18.

21. *Id.*

22. *Id.*

C. Services Provided[23]

1. Free permits for California state properties.
2. One-stop film office for California state properties.
3. On site location library and CinemaScout, (www.cinemascout.com), a web-based location finder for sites throughout California. The Location Scout is used by production personnel to access images and text on California properties that might meet specific film location needs.
4. On site California Highway Patrol ("CHP") Film Liaison available to assist with filming on state freeways and highways. This liaison also arranges for CHP officers to monitor film shoots.
5. On site California state fire marshal available to provide advice and approval for pyrotechnics and other special effect permits for state properties.
6. Coordination with more than fifty-five in-state film commissions. CFC will fax a production's location requests to designated film commission offices.
7. Production and troubleshooting assistance.

D. Comments on the Programs

Programs such as the FCF, which proposed investing $45 million over three years to offset production costs, are insufficient. Spending fifteen million dollars per year when California is missing out on a large percentage of some $16 billion is the embodiment of penny wise, pound-foolish.

Yet, even in the face of evidence that the CFC has positively affected as many as 130,000 below-the-line jobs in the past year, the organization has become a casualty of California's financial crisis. Inexplicably under Governor Davis' last budget, the CFC was set to operate in 2004 with 90 percent of its budget slashed, even though its rebate program has been used by some 2,800 productions.

23. *Id.*

III. LOS ANGELES

While the state bureaucracy struggles with its deficit and the management of a state in crisis, Southern California must act on its own out of self-preservation to protect a crucial industry. In 1992, former film czar Beth Kennedy uttered the dire prediction that, if new, preventative measures were not taken, "L.A. will become to the entertainment industry what Detroit signifies to the automobile industry."[24] Now ten years later, Los Angeles still dominates the global entertainment industry; it is no dinosaur. However, sufficient measures have not been taken to increase or retain Los Angeles-based productions.

In Southern California, steps have been taken to streamline the film permitting process in an effort to create a cooperative environment between government and industry. At the core of this endeavor is the Entertainment Industry Development Corporation ("EIDC"). The EIDC was created through the joint efforts of the Los Angeles City Council and the Los Angeles County Board of Supervisors to be the one-stop permitting authority in Los Angeles. The EIDC wants to be an effective, results-oriented organization as seen from the mission statement on their web site:

> EIDC's mission is as straightforward as they come. We deliver Los Angeles to the global entertainment industry. It's an easy assignment - the region offers unparalleled services, locations and resources. The more projects that are produced in the region, the more commerce and economic growth flows to many local communities. And this local community development is an integral part of the EIDC mission. It's a win for both sides.
>
> The EIDC provides services, solutions and answers to the varied challenges and questions that are raised when filming in the real world.[25]

In a similar effort, the Orange County Chamber of Commerce & Industry created the Orange County Film Office. "The mission of the Film Office was to market Orange County to the motion picture and allied industries, expand production throughout the area and simplify the permitting and regulatory process in the thirty-two separate jurisdictions of Orange County."[26] While streamlining bureaucracy is sure to provide some incentive to would be filmmakers, the financial incentives are the real carrot and neither Los Angeles,

---

24. Linda Keslar, *New Film Czar Kennedy to Outline Goals*, DAILY VARIETY, Nov. 19, 1992, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

25. Entertainment Industry Development Corporation, Mission Statement, *at* http://www.eidc.com/About_the_EIDC/Mission_Statement/mission_statement.html (last visited May 16, 2004) (copy on file with the *McGeorge Law Review*).

26. Jon Garon, *Star Wars: Film Permitting, Prior Restraint & Government's Role in the Entertainment Industry*, 17 LOY. L.A. ENT. L.J. 1, 31 (1996).

nor California, nor the U.S. have begun to fight that battle in a meaningful way. What is it that drives the independent producer and often times the major studios to manufacture such blockbusters as *Lord of the Rings* (New Zealand),[27] *Master and Commander* (Mexico),[28] and *Matrix* (Australia)[29] outside the entertainment capital of the world? While there are often multiple reasons for these decisions, and each film has its own story, it boils down to money.

Producers may prefer a certain crew in Canada, a location in Malta, or a facility in Australia, but the high price of everything from unionized labor to residuals to duct tape in the United States makes other countries financially appealing. For instance there are significant costs that a studio must pay simply for shooting in Los Angeles which do not exist in Australia or South Africa. An example of this is, if a production films in Los Angeles the producer will be responsible to pay the I.A.T.S.E employees residuals, known as Post-60s, which can amount to nine percent of ancillary revenues.[30] While this alone might not drive a producer to Australia, it is the aggregation of high costs of doing business that drives productions out of our cities. Add to higher costs the temptation of soft money opportunities and it is no wonder that foreign productions continue to thrive.

With a generally strong dollar and pliant locales, producers have the opportunity to feel like sultans in Malta, and barons in Prague. After all, when the king of a North African country offers you his army as extras, it's more interesting than driving to a stage in Burbank.

IV. SOFT MONEY

Soft money is a powerful lure, but what is it? When a tobacco company or teachers' union donates a large sum of money to a political candidate's campaign for public office, we call it *soft money*. The connotation is that *soft* is not as reputable as *hard*. Often times soft is used to imply *weak*, such as "the mayor was soft on crime," or Winston Churchill referring to Italy as the "soft underbelly of Europe," meaning that invading Italy would be less costly than tackling the Atlantic Wall of the channel coast. Other times we intimate that soft is contaminated, that is, soft money has too much influence in politics.

---

27. Elizabeth Guider, *Prod'n on the Move*, DAILY VARIETY, Feb. 16, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

28. *Id.*

29. Michaela Boland, *Hollywood Wizards in Oz*, DAILY VARIETY, Jan. 31, 2001, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

30. Alliance of Motion Picture & Television Producers, Producer–I.A.T.S.E. and M.P.T.A.A.C. Basic Agreement of 2000, 27-43 (2000).

A. *What Is This Soft Money and Why Is It So Important?*

The opportunities for independent film finance have gone through a series of difficult changes over the past years and soft money plays a major role in the business of independent filmmaking. The circumstances surrounding the independent producer's struggle to finance films was accurately outlined by Patrick Frater in his January 2003 *Screen International* article:

> Over the last four years, the independent film production sector has suffered a series of collapses that have successively removed most of the planks on which their businesses were built. One after the other, the insurance-backed funding business, gap financing, the pre-sales market and Europe's free- and pay-TV sectors have shrunk or disappeared. Add to that the overnight collapse of the wildly over-optimistic Neuer Markt, which briefly led many German enterprises and investors to take leave of their senses, and the increasingly risk-averse mood of US buyers, and the staple sources of funding for independent films have all disappeared since 2000.[31]

Into the void left by the collapse of the prior finance regime, whether it is German money or insurance backed money, the governments of numerous countries, states, and cities have stepped into the breach to draw production dollars to their areas. Given this environment, producers have been forced to look to new sources for funding and since the prize of a feature film is a serious value for any locale, it is no wonder that soft money became such a popular mechanism in film finance. The value of a production is clear, this is because for every dollar of production funds spent in a given territory, an additional seven in ancillary revenues are generated. The prospect of bringing such a windfall to a locale has motivated the efforts of politicians and businesspeople worldwide. However, this is an ever-changing landscape that will continue to evolve as old money sources recede from the scene and new sources take their place.

Such a change was recently witnessed when an established source of independent funding evaporated, just as another source was making its presence felt. First, the Canadian pension fund ("CDP") announced that its would no longer invest in Hollywood.[32] Shortly thereafter it was announced that the state of Louisiana had "teamed with Los Angeles-based Samy Boy Entertainment to create a $50 million production fund, LA Squared."[33]

31. Patrick Frater, *The Hard Facts About Soft Money*, SCREEN DAILY, Jan. 6, 2003, *at* http://www.screendaily.com/story.asp?storyid=10607 (copy on file with the *McGeorge Law Review*).

32. Dana Harris & Cathy Dunkley, *Funding Fizzles*, DAILY VARIETY, July 8, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*) ("CDP is reducing its private equity investments and reconsidering its Hollywood strategy out of concern that the assets have not been productive.").

33. Dana Harris, *Cajuns Cook $50 Mil Prod'n Fund*, DAILY VARIETY, July 10, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

> The fund intends to back 10-12 pics, all of which will be shot in Louisiana. . . . Equity comes from Sam Nazarian's Samy Boy and the Louisiana Economic Development Corp. The Louisiana Institute of Film Technology (LIFT) arranged debt financing. . . . LA Squared comes on the heels of legislation enacted last August designed to put Louisiana on par with Germany, Canada and the U.K. when it comes to film production tax credits. Qualifying productions can earn tax credits of up to 15% of the total production expenditures in Louisiana. While Louisiana is the first state to invest in a film production fund, New Mexico is an equity investor in the Cruise/Wagner Prods./Intermedia production "Suspect Zero." New Mexico allows productions to borrow up to $7.5 million interest-free.[34]

As this ensemble cast of characters continues to transform itself, even talent agencies are looking at ways to participate in the indie finance game. The recent announcement of the creation of El Camino Pictures demonstrates that major talent brokers like William Morris are believers in soft money and creative financing.[35]

B. *Forms of Soft Money*

Soft money comes in different forms, all of which attempt to reward a production for spending some of that multibillion dollar pool in a given area. The following is a glossary prepared by Patrick Frater of the terms that define the most popular soft money mechanisms in use.

> Soft sell: different sorts of soft money
>
> Tax credits: a system whereby a state offers a producer a rebate on film production costs spent in that country. The two most established systems of this type exist in Luxembourg and Canada. Both Australia and Iceland offer "tax offsets," which also fit this category and appear to have taken their countries' attractions to a new level. Malta also uses it.
>
> The system can be likened to going shopping abroad and claiming back the value-added tax (VAT) at the airport. The producer needs to be able to pay out the full cost of production before claiming a refund. This hurdle can be circumvented by use of specialist banks that are willing to discount the value of the future claim. Some countries are also much quicker than others in reimbursing tax already paid.

---

34. *Id.* (citations omitted).

35. Claudia Eller & James Bates, *William Morris to Set Up Film Finance Firm*, L.A. TIMES, May 17, 2003, at C2.

Tax allowances: the most widespread and potentially biggest source of soft money for film-making. It works by giving a tax incentive either to private individuals or to companies that invest in production companies or one-off film productions, sometimes through acquisition.

The German system famously works this way by creating film funds. The Netherlands' CV system of limited-liability partnerships also fits this mold, as does France's Soficas.

As no film at the project stage and few film companies have sufficient income to use the tax allowances, the trick is to turn the allowance into something with which producers can use to make their films. . . . Alternatively these can be looked at as tax deferral schemes or simply as interest-free loans from the tax authorities.

There will usually be some kind of criteria determining which films qualify for tax allowances. Germany, unusually, does not disqualify foreign productions, but the German tax advantages are only at their most efficient if all the "losses" incurred at the production stage are attributed to the country. The fund also needs to be able to have some considerable influence on the production.

Loan support: These are loans made by government institutions on generous interest or repayment terms which would not normally be available on the open market. The U.K. and Italy operate this kind of "soft loan" at a national level, while Germany's many Laender, or regions, provide loans. Alternatively, the same end may be achieved by government underwriting. In France, the state covers half the losses of some specialist film discounting agencies, while Italy and Spain have been the first recipients of guarantees from the EU-backed European Investment Bank.

Box-office rebates: a number of countries have systems which return a proportion of the box-office proceeds to producers. France has the most developed system, through its *compete de soutien* system, but Spain and some of the Nordic countries are also notable practitioners. (Some parts of the Media Plus programme use [rebates] to help distributors and exhibitors.) They have the advantage of transparency, being automatic rather than subjectively awarded, and do little to distort the distribution market because it is commercial success, not failure, that is rewarded.

Films need to qualify either through nationality or have nationality delivered through a co-production. Money from this kind of system is returned at the recoupment stage and is intended for reinvestment in future pictures. As it is not possible to be sure how much will be returned by the tax office until a film is released, this system can be tricky as a financing mechanism for a current project.

Subsidy: most European countries provide some form of cash injection to film productions on cultural or, more rarely, economic grounds. They may be administered at national or local level, have some strings attached, such as a requirement to shoot in the territory, but reimbursement is not necessarily expected. On the other hand, with the exception of the Nordic region, they rarely amount to significant chunks of a film's production budget. The EU's Media Plus programme offers all sorts of non-production subsidy, notably for script development and training.

Cheap facilities/barter: facilities ranging from entire studios and locations to cheap scouting may all be arranged or provided by national or local organisations [sic]. Studios may take an equity or co-production position in a film without putting up any cash. Rather, they discount or provide their services for free. In other cases, such [as those] of Romania, South Africa or China, the costs of labour [sic] or studio hire is so much lower than those in Western Europe or the [United States] that, although the producer cannot harness cash to put into a production budget, it amounts to soft money by any other name.

Co-productions: can be considered soft money as their purpose is generally to combine different national support systems for the benefit of a single project. They can be set up either under international treaties agreed by countries that encourage dual nationality film-making (Canada holds the record for having signed the most co-production treaties) or under the European Convention on Cinematographic Co-production. The Eurimages scheme rewards tripartite productions and bipartite financial co-productions.[36]

36. Frater, *supra* note 31.

C. Converting to Useable Cash for Production

But how do these concepts and definitions get converted to become useable cash for production? In a recent survey by the staff of *Variety* and *Daily Variety* entitled, *Tax Incentives Around the Globe*, the contributors answered this question. The ensemble of writers compiled some of the more popular soft money opportunities outlining how we go from conceptual money to money in the bank.[37]

> AUSTRALIA
> 12.5% tax credit
> DATE: Introduced in Sept. 2001
> DETAILS: Rebate is granted to producers of films and miniseries that spend at least $A15 million ($9.7 million) and 70% of their total budgets Down Under. The 70% requirement is waived for films that outlay more than $32.5 million. Government estimates the average savings is 10% of the total coin spent in Oz. . . .
>
> CANADA
> Film/Video Production Services Tax Credit
> DATES: Tax credit for foreign producers shooting in Canada was introduced in 1997 and has no end date.
> DETAILS: It's essentially a rebate on Canadian labor expenditures and can be redeemed by filling out paperwork obtained from the federal government's culture ministry, Heritage Canada. The credit was raised from 11% to 16% earlier this year, after intense lobbying from Canadian producers who often work on these films in tandem with non-Canadian producers. In addition, all of Canada's provinces also have similar tax credit programs for foreign producers. The federal tax credit can provide from 6%-8% of the overall budget. When federal and provincial credits are added together, a producer could save between 12%-16% on a given budget. . . .

37. Variety Staff, *Tax Incentives Around the Globe*, DAILY VARIETY, Nov. 2, 2003, *available at* http://www.variety.com (copy on file with the *McGeorge Law Review*).

GERMANY
DATES: Tax funds have existed since the '70s, but film investment experienced a boom in the '90s. A recent amendment in the law will change the way funds operate in the future.
DETAILS: Unlike other European tax shelters, the German tax funds are not tax-driven initiatives set up by the government to encourage local film production. The schemes are based on loopholes in commercial laws that enable top-tier taxpayers to take money that otherwise would have gone to taxes and invest it into relatively high-risk funds. As a result, the setup does not require any German expenditure and has become a major source of finance for Hollywood productions. Yet, because little of the money was actually returned to the German economy, the government recently called for an amendment. Rules for the funds were tightened and, next year, investors will have to display a real entrepreneurial involvement in their fund (i.e. they will have to become more active in the greenlighting process). How this will work in practice remains to be seen. Some players have already bowed out. Meanwhile, those fund managers who remain have become tough bargaining partners, keen to generate profits for their investors (without which tax relief is lost), and the days of "silly German money" are definitely over. . . .

IRELAND
Section 481 Relief
DATES: Introduced in 1997, expires in December 2004
DETAILS: Section 481 provides a fiscal incentive to Irish taxpayers to invest in film production. To qualify, a film must have an Irish co-producer on board, and 75% of the production work must be done in Ireland. Sums raised are typically 66% of pic budgets of up to $5.2 million and 55% of budgets $7.4 million and up. The ceiling for 481 investments is at $12.2 million. The scheme was due to expire in April 2005, but the government recently changed its plans and announced Section 481 will cease at the end of next year. Among the reasons cited: abuses of the system, as well as too few benefits to the local industry justifying the losses to the local tax base. So far, no plans have been announced for a replacement scheme. . . .

LUXEMBOURG
DATES: Introduced in 1999, ends in 2007
DETAILS: The scheme provides a cash guarantee on part of the production costs incurred in Luxembourg. Foreign producers must team with a local company and get official approval from the government. A producer must prove that a certain percentage of the production costs will be spent in Luxembourg. After an evaluation, the government issues a certificate for a certain sum that may be cashed at a Luxembourg bank.

(The bank then uses the certificate toward its taxes due.) The producer may cash the benefit when the film is completed and the actual local spending is known; some banks will provide a credit for the amount. The net value of the scheme for the producer is 25% on every euro spent in Luxembourg. In addition, above-the-line costs may be reduced, as income tax (which is much lower than in most other countries) can be paid locally. This only works if the home country of a foreign director or actor has a double taxation agreement with Luxembourg.[38]

V. UK OPTIONS: A MODEL FOR MAXIMIZING SOFT MONEY

The financial incentives for spending production dollars or pounds in the United Kingdom are an example of how multiple countries have become creative and sophisticated in their efforts to attract film production. The UK model seems to represent a viable approach to production incentives, which could be adopted in the United States. Under the current structure, a "British" film can be made under the terms of one of the United Kingdom's official co-production treaties with Germany for example and such a film could be eligible for benefits in both Germany and the United Kingdom. One of the more popular devices created to maximize the UK benefit is the UK Sale and Leaseback. A film may qualify as a British film under either Schedule 1 to the Films Act of 1985 as amended in 1999, or by operating through one of the applicable UK bilateral treaties with territorial Co-Production partners or through the multilateral European Convention on Cinematographic Co-Production.[39] This multilateral treaty is intended to encourage multilateral film co-productions with any European country that has ratified the Convention. In the United Kingdom, the Department of Culture Media and Sport[40] ("DCMS") is the entity that confirms the qualifying British film.

38. *Id.*

39. *Id.*

40. The DCMS is responsible for setting policy on UK film culture and industry issues, including: sponsorship of the Film Council and the National Film & Television School; training and diversity issues in the film industry; certification of British films including co-productions; lead for the United Kingdom in the EU Media Programme. The majority of government funding for film is channeled through the Film Council which was launched in April 2000. Its two overreaching objectives are to develop a sustainable UK film industry, and develop film culture in the United Kingdom by improving access to, and education about, the moving image.

Once a producer determines she can make a so-called British film, the production will then be eligible for a Sale and Leaseback: "A UK sale and leaseback transaction . . . brings together . . . producers . . . and investors . . . for their mutual financial benefit."[41] Additionally, "The [United Kingdom's] sale-and-leaseback scheme works by selling the entire copyright of the film to an outside investor who claims the tax rebate. The film is then leased back to the producer, allowing the investor to cover their acquisition costs and the producer to get the film distributed."[42]

> The financial benefit of these transactions is typically paid to the producers once a DCMS Certificate, confirming the film is a qualifying British Film, has been issued, that is, when the film has already been completed. However, producers invariably need the cash up front during production. As a result banks are increasingly being asked to treat the sale and leaseback transaction as akin to a distribution agreement and to discount the benefit payable on completion, in other words, to use the sale and leaseback as additional collateral. However, unlike the standard discounting of distribution agreements, banks and producers need to consider the following issues when considering the discounting of sale and leasebacks. . . . The net benefit of these deals currently available to producers is about 10% to 12.5% of the purchase price. However, in looking at the collateral value of the sale and leaseback, certain deductions need to be made. These may include an amount in respect of any moneys already received by the producer from distributors or co-producers, the amount of the bank guarantee fee and any legal and audit costs that will be incurred by the producer.[43]

Although the sale-and-leaseback scheme is conservative in its payout compared to opportunities available in other countries, the UK model is flexible and only certain elements of the film actually need to be British.

While soft money is not available to all productions, it is no wonder that foreign incentives continue to chip away at America's market share of production dollars. However, while foreign soft money has its appeal it would not be difficult for California or New York with their onerous state taxes, to emulate soft money funds by offering a meaningful tax incentive to film and television investors in an effort to create jobs and revenue for the state.

---

41. Christopher Hanson & Jason Garrett, *Discounting UK Sale and Leaseback Transactions*, TRANSMIT (Denton, Wilde, Sapte, London), Jan. 2002, *available at* http://www.dentonwildesapte.com/PDF/TransMit_FilmTV_Jan2002.pdf (copy on file with the *McGeorge Law Review*).

42. Frater, *supra* note 30.

43. Hanson & Garrett, *supra* note 41, at 1.

VI. SOLUTIONS

A positive attempt at reform has come from the federal level, where members of Congress David Dreier (R-San Dimas) and Howard Berman (D-Van Nuys) joined by a bipartisan group of members of the House of Representatives reintroduced legislation that provides wage-based tax relief for film and television projects produced in the United States: The United States Independent Film and Television Production Incentive Act of 2003, H.R. 715.[44] HR-715 is currently in the House Ways and Means Committee:[45]

> OVERVIEW:
> The bill provides a Federal income tax credit designed to address the issue of "runaway film and television production." It would encourage film and television production in the United States and employment of U.S. small business workers on such productions.
>
> DESCRIPTION:
> The wage credit would be structured as a "general business credit" in the tax code (like other business credits), and would be a dollar-for-dollar offset against any Federal tax liability. Like other business credits, it is nonrefundable to the extent a taxpayer has no further tax liability. If the credit is not used in one year (because the taxpayer had no tax liability) it can be carried back one year or carried forward up to twenty years.
>
> AMOUNT:
> There would be two tiers of credits: (1) a credit amounting to 25% of the costs of "qualified wages and salaries"—those wages and salaries paid or incurred by an employer to "qualified employees" (members of targeted group) involved in a "qualified U.S. production" (targeted activity); (2) or a credit amounting to 35% of such costs if incurred in a "low-income community" (similar to the existing definition for the "New Markets Tax Credit").
>
> DOLLAR LIMIT:
> The credit would only be available on the first $25,000 of qualified wages and salaries, i.e., all employees would qualify, but only on the first $25,000 of wages.

---

44. H.R. 715, 108th Cong. (2003), *available at* http://www.house.gov/dunn/leg/1081/CoSponsor/HR715.pdf (copy on file with the *McGeorge Law Review*).

45. Interview with Legislative Assistant of David Dreier, in Washington, D.C. (Nov. 6, 2003) (notes on file with the *McGeorge Law Review*).

QUALIFIED EMPLOYEES (Targeted Group):
The credit would only apply to the wages of any employee who performs substantially all of his/her services in connection with a "qualified U. S. production."

QUALIFIED FILM PRODUCTION IN THE U.S. (Targeted Activity):
Eligible productions would be any public entertainment or educational motion picture film (whether released theatrically or directly to video cassette or other format), television or cable programming, mini series, episodic television, movies of the week or pilots that were produced in the United States.

QUALIFYING TAXPAYERS:
The credit would be targeted to the segment of the market most impacted by "runaway production," and therefore, has additional limits:
The credit would only be available if total "wages" (i.e., labor costs) are more than $200,000 and less than $10 million; and
The credit would not be available to a production subject to the reporting requirements of 18 USC 2257 (reporting of books, films, etc. with sexually explicit conduct).[46]

H.R. 715 is an example of potential legislation that may produce real results; it appears that other proposals will be coming from the legislative branch in the near future. However, tax credits are just one form of incentives that the government could implement.

VII. CONCLUSION

The old adage is true: it takes money to make money. California must invest in common sense measures that financially reward productions for making movies in the state. A wide spectrum of opportunities exist. Some ideas are more conservative, like increasing the limits of the FCF program. Other ideas are more daring, such as emulating the U.K. sale and leaseback or the New Mexico interest free loan program. It is in the interest of the public that all of these concepts be considered.

From the public relations standpoint, more must be done to show Californians that it is not simply highly paid crew personnel and unions that are suffering because of runaways. Rather, the loss of jobs is hurting the baker and metal shop in their neighborhood and the loss of tax dollars is hurting their roads, police departments, and schools.

46. Press Release, Congressman Howard Berman, Drier, Berman Reintroduce Runaway Production Legislation (Feb. 12, 2003), *available at* http://www.house.gov/apps/list/press/ca28_berman/Runaway_Production.html (copy on file with the *McGeorge Law Review*).

At times, it seems as though the U.S. film business is locked in a time warp, living in the days before business globalization and the technology revolution. As times change, so too must the unions, governments, studios, and citizens; otherwise, the outsourcing of entertainment jobs overseas will continue.

It is time for California to forge an aggressive strategy to keep production jobs and money in state. Californians can neither wait for the federal government to solve this problem nor adopt a wait and see attitude. This is not an alarmist attitude; this is a pragmatic one. If effective steps are not taken, California's film industry will slowly, but surely, become obsolete. There may be studios in California for the foreseeable future but, then again, there are still factories in Detroit.

* * *