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# TESTIMONY OF ROBERT TANNENWALD, SENIOR FELLOW, CENTER ON BUDGET AND POLICY PRIORITIES, BEFORE THE JOINT COMMITTEE ON REVENUE, MASSACHUSETTS LEGISLATURE,

## On Massachusetts' Film Tax Credits

Chairman Kaufman, Chairman Downing, and other members of the Committee:

Thank you for the opportunity to address you this morning. For the record, I am a Senior Fellow at the Center on Budget and Policy Priorities. The Center on Budget and Policy Priorities is a non-partisan research and policy institute which works at the federal and state levels on fiscal policy and public programs that affect low- and moderate-income families and individuals.

Prior to joining the Center in January, I was a Vice President and Economist at the Federal Reserve Bank of Boston, an institution I served for 28 years. During my last five years at the Fed, I directed its New England Public Policy Center, which I founded in 2005. Over the course of my 35-year career, I have focused primarily on state and local taxation. I have directed the research of two Massachusetts legislative tax commissions and served as a member of a third, Governor Patrick's 2007 Commission on Corporate Tax Policy. I have played similar roles in tax commissions in New Hampshire and Rhode Island. I served as President of the National Tax Association in 2007. I hold a combined Ph.D. in economics and government.

Massachusetts' film tax credit provides an enormous financial cushion to producers who shoot films within the Commonwealth.[1] The credit equals 25 percent of the cost of production, no matter how well the movie does at the box office, how efficiently it is produced, what critics say about it, or whom they hire to make the movie. (Note that the credit is only one way that the Commonwealth subsidizes the film industry. For example, the Commonwealth also exempts qualifying productions from all sales taxes on their purchases of goods and services used in production.)

If the film producer owes no corporate income taxes to Massachusetts because it is covered by other tax shelters or the movie is unprofitable, the Commonwealth will pay the producer 90 cents on the unused tax credit dollar, no strings attached. Or the producer can sell its unused tax credits to a

[1] Technically, the law provides for two film tax credits, one for payroll and one for other costs of production. Currently, the rate of each tax credit is 25 percent. I refer to these two separate tax credits simply as "the film tax credit."

financial intermediary at a modest discount. The financial intermediary then packages and sells the unused credits it acquires to businesses that have nothing to do with filmmaking but can use the tax credits because they owe taxes to Massachusetts. Both options put cash in the producer's hands.

What a great deal for film makers! But what about the other parties at the table, the six and a half million citizens of Massachusetts? What have they gotten out of the arrangement? In particular, how many good jobs have these credits created for them? At what cost? How much have these tax credits boosted residents' income? These are the most important standards by which all tools of economic development, including the film tax credit, should be judged.

The best analysis of these impacts can be found in a study published by the Massachusetts Department of Revenue (DOR) last July.[2] It analyzes the tax credit's economic impacts in calendar years 2006 through 2008, the latest year for which data were available. The report is the most thoughtful, meticulous, transparent, technically sound study of the Commonwealth's film tax credit yet to be published. It is based in part on tax data to which no one else has access. Perhaps in part for these reasons, many protagonists in the debate about the film tax credit, both proponents and opponents, cite its results to support their position.

## The Most Important Points the Report Makes Are the Following:

- The bulk of the film tax credit's economic benefits have gone to non-residents.

- Most of the jobs created as a result of the tax credit have been part-time, typically lasting just a few days or weeks.

- The film tax credit has been a highly inefficient engine of job creation for Massachusetts' residents. Calculations from data provided in the DOR report show that each net new "full-time equivalent" job (FTE) created for a Massachusetts resident — an FTE that otherwise would not have been created were it not for the film tax credits — most likely cost the Commonwealth about $88,000 per year or more.

- In 2008, DOR estimated that the sum of film tax credits paid out minus withholding of taxes on wages and salaries paid to film production workers equaled $60.2 million. Without prior knowledge of the indirect effects of the tax credits, the Commonwealth had to cut spending and/or raise taxes by this amount to insure a balanced state budget. These budget-balancing measures hurt the Commonwealth's economy, shrinking residents' income and employment.

- Producers have yet to claim many of the tax credits earned or purchased in 2008 (and some in prior years). According to DOR, most unclaimed credits will be taken by taxpayers on their 2009 and 2010 tax returns. When this "other shoe drops," film tax credits will become even more of a liability to the Commonwealth's finances than in the past. More spending cuts, or more tax increases, will therefore be necessary to balance its budget. The negative economic impact of these budget measures will therefore be greater. Consequently, the long-term cost per new FTE created by film tax credits earned in 2008 may climb above $88,000.

[2] Commonwealth of Massachusetts. Department of Revenue, "A Report on the Massachusetts Film Industry Tax Incentives". July 2009. http://www.mass.gov/Ador/docs/dor/News/2009FilmIncentiveReport.pdf.

## Additional Detail on the Key Points:

- ***<u>The bulk of the film tax credit's economic benefits have gone to non-residents</u>.*** DOR estimates that between 2006 and 2008, features films, which garner most awarded film tax credits, issued 45 percent of their payroll to employees earning over $1 million — the movie stars. Most were non-residents. Of the remaining employees, 59 percent were non-residents. Their median annual salary was $99,000. The 41 percent who were residents earned a median annual salary of $68,000. Although residents claimed the bulk of jobs indirectly induced by the tax credits, these positions accounted for only one-third of all induced FTES and their average wages (for workers in occupations like carpenters and hairdressers) were far lower than those working directly for the film companies (camera operators, set designers, choreographers).

- ***<u>Most of the jobs created as a result of the tax credits have been part-time</u>.*** According to the report, the average duration of jobs in the film productions claiming tax credits ranged "from a few days to at most a few months." By nature, employment in film production is short-term. Hence, measures of employment generated by the film tax credits must translate the number of jobs created to "full-time employment equivalents," that is divide the number of months worked by 12 or the number of weeks worked by 52. For example, it would take three four-month jobs at 40 hours per week to make one full-time job equivalent.

- ***<u>The job creation is very costly</u>.*** In 2008, each net new full-time equivalent job created for a Massachusetts resident — a job that would not have be created were it not for the film tax credits — cost the Commonwealth approximately $88,000 in foregone revenue. Table 1 shows how this figure, one cited by Representative D'Amico and one with which I concur, is derived from the data in the report.

| TABLE 1: Massachusetts Department of Revenue Data Show that Taxpayers Pay $88,000 Per Job Created by Film Tax Credit in 2008 | | |
|---|---|---|
| (1) | Total revenue expected to be lost due to film tax credits claimed for production undertaken in 2008 (Table 1, p.5) | $112.6 million |
| (2) | State tax revenue recouped through taxes generated by indirect economic activity, per dollar of tax credit after all indirect economic effects have been taken into account, including budget balancing spending cuts (Table 7, p. 17) | 0.16 |
| (3) | Net revenue cost of film tax credits ([1-.16] multiplied by (1)) | $94.6 million |
| (4) | Number of net new full time equivalent jobs for Massachusetts residents created by film tax credits (Table 7, p. 17, line 7 + line 9) | 1,076 |
| (5) | Cost per job created [(4)/(5)] | $88,000 |
| Note: Table and page references are to the Massachusetts DOR report. | | |

- ***<u>Many of the tax credits earned between 2006 and 2008 have yet to be claimed, so the cost per job is likely to rise.</u>*** As noted above, in its report, DOR assumed that the Commonwealth reduced state spending by only $60.2 million in 2008 to balance its budget, a combination of $73.5 million in credits paid out and $13.3 million in withholding of taxes on wages paid to employees of producers qualifying for the film tax credit.[3] Yet $112.6 million in film tax credits were approved in that year. Thus, $39.1 million in tax credits ($112.6 million - $73.5 million) have yet to be cashed in. They belong primarily to financial institutions and utilities, who bought them on the secondary market. DOR surmises that most will be claimed on 2009 and 2010 tax returns. When they are claimed, the Commonwealth will have to cut spending and/or raise taxes further to keep its budget balanced. The resulting loss in jobs and income should really be attributable to the credits approved in 2008. Consequently, the number of new FTEs attributable to the credits is probably lower than that shown in Table 1, and the estimated $88,000 cost per job is probably too low.

## The Revenue Department's Report Has Been Misinterpreted in a Number of Ways:

*Claim: The film tax credit has been a huge success because, even though $166.3 million of the credits have been earned between 2006 and 2008, they have generated $870 million in economic output and $511 million in state gross domestic product. Consequently, its return is several multiples of its cost.* Reality: These statistics bear little relationship to the benefits flowing to Massachusetts residents. Most of the benefits of the increased GDP have accrued to non-residents. Economic output is not a very useful concept primarily because it involves double counting of actual economic activity.[4]

A more telling statistic in the DOR report is the amount of additional personal income generated as a result of the film tax credit. Personal income measures only income earned by Massachusetts' residents. In 2008, the film tax credit generated $64.7 million in net additional personal income, compared to $94.6 million in the net revenue cost of the tax credit in that year. Each net dollar in revenue loss, therefore, generated less than 69 cents in additional personal income for citizens of the Commonwealth.

*Claim: Other states are making their tax credits more lucrative, so Massachusetts has to keep up to stay competitive.* Reality: As the evidence on the impacts of film tax credits has grown, more and more states have reined in their film tax credits or are seriously thinking of doing so. Kansas has suspended its film tax credit for two years. Rhode Island has curtailed the generosity of its credit in the face of a huge budget deficit and growing skepticism about its cost effectiveness. Iowa is considering repeal after temporarily suspending its film tax credit to investigate corruption charges against film producers. Measures to pare back film tax credits have also been proposed in Oklahoma and Michigan. Massachusetts should be considering similar moves, such as those recommended in H. 3854.

Mel Brooks got it right. Before the release of one of his movies, he told his cast and crew, "This movie will make millions. Unfortunately, it cost millions."

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[3] DOR also took into account revenues lost through the film sales tax exemption and gained through miscellaneous taxes. These small revenue losses and gains canceled each other out.

[4] To illustrate, suppose a film company hires a carpentry firm to build a set. The carpentry firm charges the film company $25,000 to complete the project. The cost of the lumber used in making the set is counted twice as economic output. The lumber was made in a nearby mill, before the film production began. The lumber's value, including some profit for the mill, is $10,000. This $10,000 is then counted in Massachusetts' gross domestic product. The carpentry firm buys the lumber from the mill for $10,000, builds the set, and values its work, including profit, at $15,000. The firm presents the movie producer with a bill for $25,000, which includes both the value of the carpentry work and the value of the lumber. The $10,000 in lumber is then counted again as economic output. In this manner, the increase in production attributable to the film results in double counting of the value of the lumber.