

EVALUATION OF THE MARYLAND FILM PRODUCTION ACTIVITY TAX CREDIT



DEPARTMENT OF LEGISLATIVE SERVICES 2015

Evaluation of the Maryland Film Production Activity Tax Credit

**Department of Legislative Services
Office of Policy Analysis
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Primary Staff for This Report

Robert Rehrmann
Matthew Bennett
Benjamin Blank
George Butler, Jr.
Mya Dempsey
Mindy McConville
Maureen Merzlak
Heather Ruby

Other Staff Who Contributed to This Report

Ryan Bishop
John Rohrer

For further information concerning this document contact:

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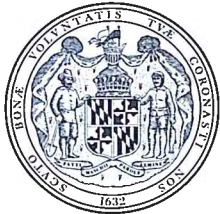
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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF THE EXECUTIVE DIRECTOR
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

September 30, 2015

The Honorable Richard S. Madaleno, Jr., Co-chair, Tax Credit Evaluation Committee
The Honorable Jay Walker, Co-chair, Tax Credit Evaluation Committee
Members of the Tax Credit Evaluation Committee

Ladies and Gentlemen:

As you know, the Tax Credit Evaluation Act of 2012 (Chapters 568 and 569) establishes a legislative process for evaluating certain tax credits. To assist the Tax Credit Evaluation Committee in its work, the Department of Legislative Services (DLS) was required to evaluate the credit on a number of factors, including (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments.

The report makes several recommendations related to the credit. The document is divided into six chapters.

Chapter 1 provides an overview of State tax credits, the Tax Credit Evaluation Act, and film production incentives in Maryland and other states;

Chapter 2 reviews the intent and objectives of the film production activity tax credit;

Chapters 3 and 4 assess the economic and employment impacts of the film production activity tax credit and Maryland's film industry;

Chapter 5 discusses the impacts of film incentives on the U.S. economy and in selected states; and

Chapter 6 summarizes the findings of the report and discusses recommended changes to the film production activity tax credit.

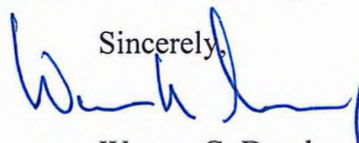
The Honorable Richard S. Madaleno, Jr., Co-chair, Tax Credit Evaluation Committee
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Page 2

During the 2014 interim, the committee reviewed a draft of this report and also held a public hearing on the report. In the 2015 session, the General Assembly passed legislation enacting significant changes to the program, including a repeal of the program's termination date. Senate Bill 905 (Chapter 486) converted the program from a traditional tax credit program with statute specifying the maximum amount of credits that can be awarded in each year to a tax credit program that is subject to an annual appropriation in the State budget. The amount of credits that the Department of Business and Economic Development (DBED) can award in each fiscal year, beginning in fiscal 2017, cannot exceed the amount of money appropriated in the State budget for this purpose. Chapter 486 states that it is the intent of the General Assembly that the appropriation equal the amount DBED reports as necessary to maintain the current level of film production activity in the State and to attract new film production activity to the State. The legislation also requires DBED to report annually a list of the businesses that directly provided goods or services to a film production entity that claimed the film production activity tax credit and (1) qualified as a minority business enterprise under State procurement law and (2) are determined by DBED to be a small business.

DLS estimates that the legislation will increase general fund expenditures by \$25.0 million annually beginning in fiscal 2017. However, as required by Chapter 486, DBED reports that maintaining the current level of film production activity will require \$14.4 million in funding plus an additional \$46.8 million in order to attract new film production activity. The total amount of estimated funding, \$61.2 million, would represent a significant expansion in program funding.

After filming four seasons in the State and receiving \$22.7 million in film production activity tax credits, *VEEP* moved production out of state subsequent to the California Film Commission awarding a \$6.5 million film tax credit for its next season of production. California recently increased its annual film tax credit funding from \$100.0 million to \$330.0 million. While California, New York, Georgia, and Pennsylvania have maintained or increased funding for film tax credit programs, other states have recently reduced or repealed programs. Louisiana and North Carolina placed an aggregate annual limit on previously uncapped film tax credit programs, Alaska and Michigan have repealed programs, and New Jersey has recently allowed funding for its program to lapse.

We wish to acknowledge the cooperation and assistance provided by various State agencies in the development of this report. DLS trusts that this report will be useful to members of the Tax Credit Evaluation Committee in future deliberations about the film production activity tax credit.

Sincerely,

Warren G. Deschenaux
Executive Director

WGD/mpd

cc: Thomas V. Mike Miller, Jr., President of the Senate
Michael E. Busch, Speaker of the House of Delegates

Contents

Letter of Transmittal	iii
Executive Summary	vii
Chapter 1. Overview and Background	1
Overview	1
Tax Credit Evaluation Act.....	2
Evolution of Film Incentives in the United States	3
Maryland Film Incentives	13
Film Production Activity Tax Credit.....	17
State and Local Revenue Impacts	21
Film Tax Credit Funding Compared to Other State Business Tax Credits.....	23
Chapter 2. Intent and Objectives	25
Rationale for Government Intervention	25
Other State Tax Credits Clearly Identify an Outcome or Efficiency Goal	26
Chapter 3. Economic Impacts	29
The REMI Model	29
Model Data and Assumptions	30
Estimated Economic Impacts	33
Scenario #1 – Production Activity and Fiscal 2012-2016 Tax Credits.....	33
Scenario #2 – Economic Impact of a \$15 Million Film Tax Credit.....	37
State and Local Return on Investment	38
Decreasing Cost Effectiveness of State Incentives	40
Estimated Economic Impact of Various Incentives	42
Chapter 4. Impacts of Maryland’s Film Industry	45
The Film Industry is a Minor Employer in Maryland.....	45
Maryland Film Industry Employment Over the Last Decade	45
Film Tourism in Maryland	47
Chapter 5. Impacts of Film Incentives on the U.S. Economy and in Selected States	49
Benefits to the U.S. Economy are Less Than Estimated.....	49
Economic and Fiscal Impact of Other State Tax Incentives	49
Michigan Film Incentives.....	50
Louisiana Film Incentives	54
Chapter 6. Findings and Recommendations	57

Executive Summary

Since the mid-1990s, the number of State business tax credits has grown exponentially, as have related concerns about the actual benefits and costs of many of these credits. Although tax credits comprise a small percentage of total income tax revenues, the number and amount of credits claimed have significantly increased over time.

In response to concerns about the fiscal impact of tax credits on State finances, Chapters 568 and 569 of 2012, the Tax Credit Evaluation Act, established a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee that is appointed jointly by the President of the Senate and the Speaker of the House of Delegates. The Act requires that the film production activity tax credit be evaluated by the committee by July 1, 2015. To assist the committee in its work, the Department of Legislative Services (DLS) is required to evaluate the credit on a number of factors, including (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments.

Film production incentives have gained popularity in the past decade, with 37 states and the District of Columbia offering them in 2014. Maryland began offering financial assistance to encourage film production activities in 2001 and adopted the current film production activity tax credit beginning in 2012. The costs of film incentives to states

has risen dramatically as a result of both the increase in the number of states offering incentives and increases in the generosity of programs as states compete to attract productions. As competition has increased and costs have escalated, questions have been raised about the impact of film incentives on economic development and state finances.

This report provides an overview of the film production activity tax credit, including how the credit is claimed, the amount of credits claimed, the economic impacts of the credit, and film production incentives in other states. DLS also makes several recommendations related to the tax credit.

The Film Production Activity Tax Credit Does Not Provide Sustainable Economic Development

As discussed in this report, the economic development activity generated by film productions is of a short duration. As soon as a film production ends, all positive economic impacts cease too. As such, the film production activity tax credit does not provide long-term employment. Maryland has provided \$62.5 million in tax credits between fiscal 2012 and 2016 while only receiving a fraction of the tax credit amounts back in revenues to the State and local governments. Additionally, states are fiercely competing with one another to draw productions into their state. This type of competition is not only expensive, but promotes unhealthy competition among states. It is also very difficult, if not impossible, to determine how much funding the State would have to provide each year in order to develop a sustainable film industry

that is also cost effective to the State and local governments.

Recommendation: Since the credit does not provide sustainable economic development and provides a small return on investment (ROI) to the State and local governments, **DLS recommends that the General Assembly allow the film production activity tax credit to sunset as scheduled on July 1, 2016. Going forward, DLS recommends that the General Assembly focus economic development efforts on incentives that create permanent and lasting employment, rather than temporary jobs.**

However, if the General Assembly decides to extend the film production activity tax credit beyond July 1, 2016, DLS has several recommendations, to improve the credit, that are discussed below.

The Film Production Activity Tax Credit is not Linked to a Production's Taxable Income or Tax Liability

Generally speaking, most tax credits are tied to the income generated by and tax liability of the individual or business claiming the credit. The tax credit is claimed by the taxpayer and may or may not eliminate tax liability; if it does not, any remaining credit can usually be carried forward to additional tax years or may be refundable.

In the case of the film production activity tax credit, the film production entity (or the members of the entity) must file an income tax return in order to claim the credit. After the Department of Business and Economic Development (DBED) issues a final credit certificate to the entity, the entity must then

amend its tax return to claim the credit. Since the credit is refundable, however, whether or not the film production entity generates taxable income or has any tax liability does not matter. Additionally, as with many business tax credits, DBED certifies credits and the Comptroller's Office processes credit claims on tax returns. Since tax returns are confidential, the Comptroller's Office cannot share specific information with DBED about the returns filed or the timing of tax credit claims.

Recommendation: Since the film production activity tax credit does not have a direct connection to a film production entity's taxable income or tax liability, **DLS recommends that the General Assembly consider replacing the tax credit with a grant program funded through the State budget and administered by DBED.** While providing funding through a grant program could cause some uncertainty about funding levels from year to year, there is no compelling reason why film production incentives should be accessed through the tax system. Replacing the tax credit with a grant program could also aid in credit transparency and reduce administrative burdens.

Film Production Activity has Benefited Some Local Jurisdictions More than Others

Businesses in Baltimore City and Baltimore, Harford, and Anne Arundel counties have primarily benefited from film productions that receive the film production activity tax credit. Of the over 7,000 vendors used to date, 80% have been located in these four jurisdictions. Meanwhile, Garrett, St. Mary's, and Somerset counties do not have any reported vendors benefitting from film productions in their jurisdictions.

Additionally, productions that predominantly highlight a jurisdiction may increase film tourism in the area, benefitting the jurisdiction.

Recommendation: Based on DLS' analysis, for every dollar granted in film tax credits, the State receives 6 cents and local governments receive about 4 cents in return. Since local governments receive approximately 40% of the film credit's ROI, **DLS recommends that the General Assembly require local governments to contribute a portion of the State's tax credit costs for productions in which at least 50% of the principal photography occurs in that jurisdiction. Alternatively, local governments could contribute a portion of the tax credit's costs based on the proportion of production expenditures in their jurisdictions.**

DBED Should Provide Additional Information about the Film Production Activity Tax Credit and Similar Incentives in Other States

Current law requires DBED to annually provide information to the Governor and General Assembly on the number of film production entities submitting tax credit applications; the number and amount of tax credit certificates issued; and information about local actors, technicians, and vendors used for film production activity. However, DBED does not provide any information on the size of the vendors or businesses used or how many are small, minority-, and/or women-owned businesses. In addition, DBED does not report any information on film production incentives provided in other states.

Recommendation: Considering the General Assembly's interest in providing business opportunities for small, minority-, and women-owned businesses, **DLS recommends that the General Assembly require DBED to monitor and report in its annual report on the number of film production vendors that qualify as small, minority-, and women-owned businesses. In addition, if the data collected suggests that these businesses consist of only a small percentage of the vendors, DBED should consider methods by which film production entities can provide opportunities for small, minority-, and women-owned businesses.**

Recommendation: Considering the nature of the tax credit and the number of states that have continued to increase the types and amounts of incentives awarded, **DLS recommends that the General Assembly require DBED to routinely report annually information on the film production incentives provided in other states, particularly for states with large tax credit programs such as California, New York, Louisiana, and Pennsylvania.**

The Vast Majority of Film Production Activity Tax Credits Have Been Awarded to Two Productions

The Film Production Rebate Program was converted to a tax credit beginning in fiscal 2012. Since that time, approximately \$62.5 million in tax credits have been authorized by the General Assembly. Of that amount, \$60.3 million, or 96.5% of the total, has been awarded to two productions – *House of Cards* and *VEEP*. During that time period, only three other productions have been awarded tax credits, for a total of \$1.5 million. While larger productions of

feature films or television series may certainly provide significant spending in the State, it is not clear if portions of the credits provided to these two productions could have instead been allocated to a larger number of productions, potentially providing economic benefits to additional jurisdictions in the State. In addition, information is not readily available as to how DBED and the Maryland film industry work to attract film or television productions to the State and how determinations are made to allocate tax credits to those productions.

Recommendation: DBED should comment on the process and criteria used to attract film and television productions to Maryland and how allocations of tax credits to these productions are determined. The General Assembly may also wish to consider developing specific criteria to be used by DBED in determining whether productions should be allocated tax credits, including whether limitations on the amount of tax credits that any single production may receive in a given fiscal year would be appropriate.

Film Production Companies Pit States against One Another for Incentives

As discussed in this report, film production entities “shop around” for the most lucrative state film incentives. While this is often the case with businesses in general, particularly businesses with multi-state operations, most businesses do not come to a state to conduct business, qualify for tax incentives, and then quickly threaten to leave. Businesses usually qualify for tax incentives, set up a physical location in which to do business, and stay if they become profitable. However, even if a

motion picture or television series comes to a state to film, there is no guarantee that the production will stay to film sequels or additional seasons. Not only will they not be guaranteed to stay, but they may threaten to leave the state if additional incentives are not provided (*i.e.*, *House of Cards* in 2014). States then increase incentives in an attempt to keep productions, or to lure them from other states, which may not be in the best economic interest of the taxpayers in those states.

Recommendation: DBED should comment on, as a condition of receiving tax credits, the feasibility of requiring a film or television production to commit to staying in the State for the duration of the production of the film or series, essentially requiring a multi-year commitment to the State when appropriate.

Recommendation: The General Assembly may wish to consider legislation that would require the recapture of tax credits awarded to or claimed by a production entity that later leaves the State to film in another jurisdiction, similar to language contained in the version of Senate Bill 1051 of 2014 as passed by the House of Delegates.

Chapter 1. Overview and Background

Overview

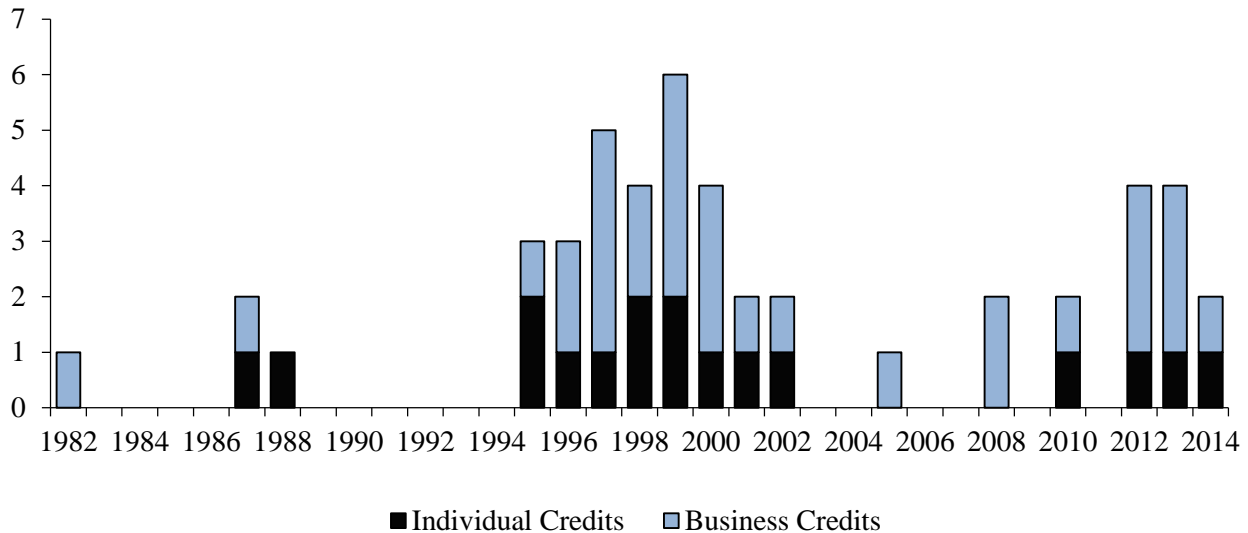
Film production incentives have gained popularity among states in the past decade, with 37 states and the District of Columbia offering them in 2014. Maryland began offering financial assistance to encourage film production activities in 2001. This assistance evolved into the current film production activity tax credit, which began in 2012. A qualified film production entity that meets specified requirements and is approved by the Department of Business and Economic Development (DBED) may receive a refundable tax credit of up to 25% of the qualified direct costs of a film production activity. A television series may receive an enhanced credit of up to 27% of qualified direct costs.

The cost of state film incentives has risen dramatically as a result of both the increase in the number of states offering incentives and increases in the generosity of programs as states try to remain competitive with each other. With increased competition among states and escalating costs, questions have been raised about the impact of film incentives on economic development and state finances.

Since the mid-1990s, the number of State business tax credits has grown significantly, as have related concerns about the actual benefits and costs of many of these credits. Although the reduction in State revenues from tax credits is generally incorporated in the State budget, most tax credits are not subject to an annual appropriation as required for other State programs. However, a few credits are subject to a budget appropriation, including the biotechnology investment and sustainable communities tax credits, and State reimbursement for one-half of the local property tax credit costs under the Enterprise Zone Tax Credit Program. Reporting information for State tax credits varies. Under certain tax credit programs, agencies are required to publish specified information about the credit on an annual basis. The Department of Budget and Management (DBM) is required to prepare every other year a statement of the estimated amount by which exemptions from all types of State taxation reduces revenues.

Although tax credits comprise a small percentage of total income tax revenues (less than 3% in fiscal 2009), **Exhibit 1.1** shows that the number and amount of credits claimed has increased over time. Prior to 1995, there was one credit for individuals (earned income credit) and two primarily business tax credits (enterprise zone and Maryland-mined coal credits). Since 1995, 29 tax credits primarily for businesses and 15 tax credits primarily for individuals have been established. This includes temporary and expired tax credits. Twenty-nine of the credits were established between 1995 and 2002. More recently, 10 credits have been established since 2012, including 7 primarily for businesses. The total amount of credits has increased from a little less than \$50 million in tax year 1994 to about \$250 million in tax year 2008. Most of this increase has been due to an increase in tax credits for individuals, and in particular earned income credits, which have increased by almost five-fold since 1994.

Exhibit 1.1
Number of Tax Credits Created Each Year
1982-2014



Source: Department of Legislative Services

Tax Credit Evaluation Act

Overview

In response to concerns about the impacts of certain tax credits, Chapters 568 and 569 of 2012 established the Tax Credit Evaluation Act, a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee and must be done in consultation with the Comptroller's Office, DBM, the Department of Legislative Services (DLS), and the agency that administers each tax credit. The committee is appointed jointly by the President of the Senate and the Speaker of the House of Delegates and must include at least one member of the Senate Budget and Taxation Committee and one member of the House Ways and Means Committee.

The following credits are required to be reviewed by the date indicated:

- July 1, 2014: enterprise zone and one Maryland credits;
- July 1, 2015: earned income and film production activity credits;
- July 1, 2016: sustainable communities and research and development credits; and
- July 1, 2017: businesses that create new jobs, biotechnology investment, and wineries/vineyards credits.

In lieu of the evaluation dates listed above, if a tax credit has a termination date provided for by law, an evaluation of that credit must be made on or before July 1 of the year preceding the calendar year of the termination date.

Department of Legislative Services' Evaluation

By June 30 of the year prior to a tax credit's evaluation date, the evaluation committee is required to meet with the Comptroller's Office, DBM, DLS, and the agency that administers the credit to prepare a plan for evaluation. By October 31 of the same year, DLS is required to publish a report evaluating the tax credit.

The report submitted by DLS must discuss:

- the purpose for which the tax credit was established;
- whether the original intent of the tax credit is still appropriate;
- whether the tax credit is meeting its objectives;
- whether the goals of the tax credit could be more effectively carried out by other means; and
- the cost of the tax credit to the State and local governments.

By December 14 of the same year, the evaluation committee must hold a public hearing on the evaluation report. By the twentieth day of the legislative session before the evaluation date of a tax credit, the committee is required to submit a report to the General Assembly that states whether or not the tax credit should be continued, with or without changes, or terminated.

Evolution of Film Incentives in the United States

The Early Days of Film Production

Hollywood is synonymous with the television and motion picture industry. Originally centered in New York, the film industry migrated to Southern California in the early twentieth century in order to take advantage of weather conducive to year-round filming and a diverse geography. Additionally, productions may have wanted to distance themselves from the patent wars and litigation on the East Coast surrounding Thomas Edison's monopoly on patents.

During most of the twentieth century, the industry continued to film in the Hollywood area to contain costs. The entertainment industry union created the 30-Mile Studio Zone within the Los Angeles area, which determined rates and work rules for union workers. Filming within the 30-mile zone is considered local, and many unions and guilds require higher compensation for work that occurs outside of the 30-mile zone. These favorable work rules and other labor provisions helped the film industry maintain its concentration within the Los Angeles area. However, in the past 20 years or so, California's dominance of the film industry has eroded, due in part to the rise of film incentives in other states.

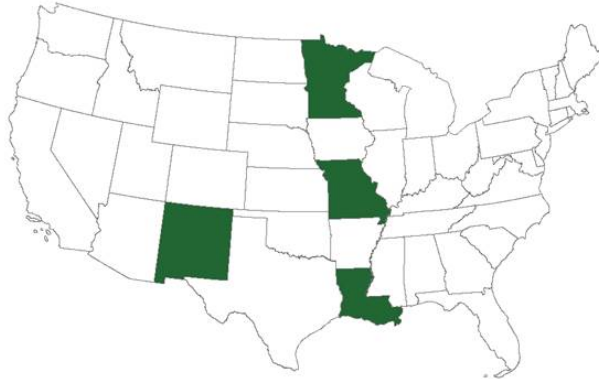
The Rise of Film Incentives

New technology facilitating location shooting and favorable exchange rates in the 1970s helped Canada attract the attention of the U.S. film industry. However, it was not until the 1990s that film productions began to grow substantially in that country. Canada began to offer sizeable tax incentives in 1998, and Canadian production expenditures grew by \$617 million (144%) from 1999 to 2001. Other countries and states took note and soon emulated Canada's film incentives.

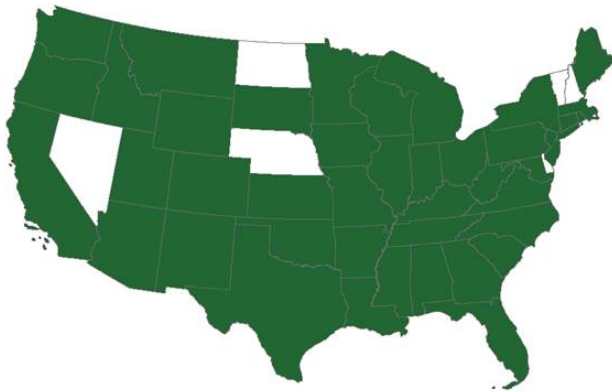
States have been attracting productions away from California by offering television and film productions a variety of incentives. In 1992, Louisiana became the first state to offer film production incentives by providing a tax credit for certain investment losses incurred in the production of films in the state; however, it was not until 2002 that the modern Louisiana Motion Picture Investor Tax Credit program was created. During this period, four more states – Hawaii (1997), Minnesota (1997), Missouri (1999), and New Mexico (2002) – and Puerto Rico (1999) had also adopted various film production incentives. By 2009, the number of states offering film production incentives had climbed to 44 and the District of Columbia, as shown in **Exhibit 1.2**. Only Delaware, Nebraska, New Hampshire, Nevada, North Dakota, and Vermont did not offer any type of film production incentive in 2009. Recently, though, due to increased pressure on state budgets resulting from the economic downturn of the middle and late 2000s, as well as questions regarding the return on investment (ROI) of film production incentives to state economies, the number of states offering film production incentives in 2014 has decreased to 37 and the District of Columbia.

Exhibit 1.2
States with Film Incentives in 2002, 2009, and 2014

2002



2009



2014



Source: Tax Foundation; Ease Entertainment Services; Department of Legislative Services

Types of Film Production Incentives

Film production incentives include cash rebates, grants, and tax credits, including both refundable and transferable tax credits. Refundable tax credits allow a taxpayer to claim a refund if the value of the credit exceeds the tax liability imposed in the year. Since the value of the credit is typically greater than any tax liability, productions usually receive significant refunds in each year. Transferable credits allow film productions to sell a tax credit to an entity with state tax liability. The transferred credits are then claimed by the entity with state tax liability. Tax credits are the most popular form of incentive and are provided by 26 states in 2014. Eight states and the District of Columbia currently provide production companies with some form of rebate whereby production companies are reimbursed directly for a portion of their production costs. Grants are the least common form of film production incentive and are primarily used in Texas, while Montana and Virginia also provide grants to production companies in conjunction with tax credits.

Typically, production companies must spend minimum amounts in the state on goods and services and employ a certain number of workers to qualify for tax credits. As shown in **Exhibit 1.3**, 13 states offer refundable tax credits and 11 offer transferable tax credits; Louisiana and Massachusetts have both refundable and transferable tax credits. Of the 11 states with no annual cap on incentives, only 3 have nonrefundable incentives. By not capping the incentives or not limiting the incentives to tax liability, the costs of the incentives have the potential to become significant. For example, in 2013, North Carolina awarded \$61 million in film incentives. A recent analysis by the North Carolina General Assembly's Fiscal Research Division determined that the program created a minimal number of jobs and generated a low ROI for the state. Given the program's escalating costs, questions over the program's effectiveness, and the desire to level the playing field for all businesses, North Carolina replaced the tax credit program with a \$10 million annual grant program that began January 1, 2015.

Exhibit 1.3 Types of State Film Credits Calendar 2014

	<u>Uncapped</u>	<u>Annual Cap</u>	<u>Total</u>
Refundable	3	10	13
Transferable	3	8	11
Refundable and Transferable	2	0	2
Nonrefundable	3	9	12
Total	11	27	38

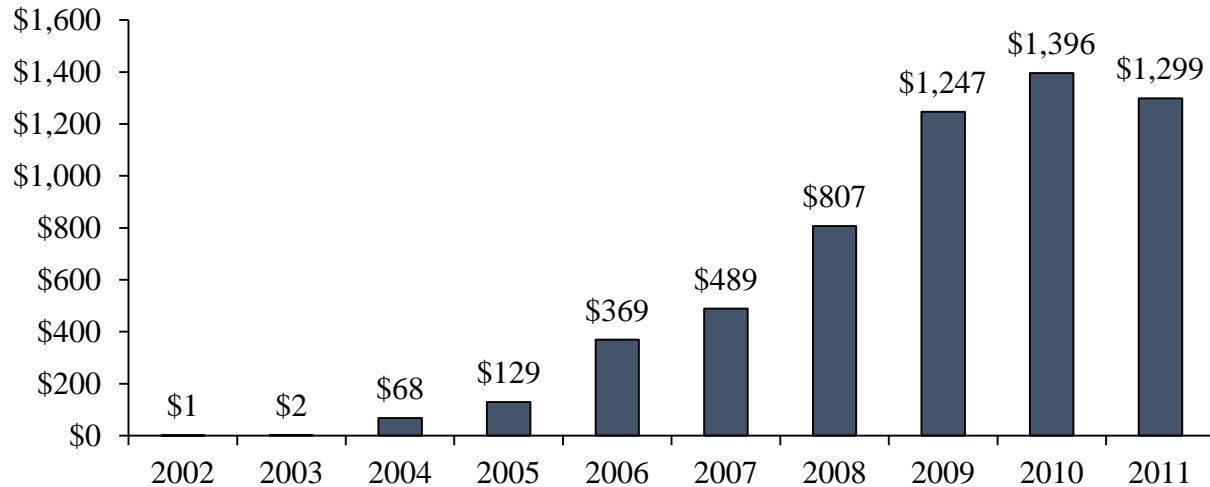
Source: Ease Entertainment Services; Department of Legislative Services

In 2013, New York provided the most tax incentives (\$420.0 million), followed by Louisiana (\$251.0 million), California (\$100.0 million), North Carolina (\$63.6 million), and Pennsylvania (\$60.0 million). Of these programs, North Carolina and Louisiana did not limit the amount of credits that could be awarded in each year. Alaska currently has a \$200.0 million aggregate cap over a 10-year period, and it provides a credit of up to 58% of qualified expenditures. Pennsylvania's annual statutory cap has fluctuated, decreasing from \$75.0 million in fiscal 2009 to \$42.0 million in fiscal 2010, then increasing to \$60.0 million in fiscal 2011, but the structure of the credit has remained unchanged since its 2007 enactment. During Pennsylvania's 2014 legislative session, there was an unsuccessful push by advocates of the television and film industry to remove the annual cap in order to prevent productions from leaving the commonwealth. In addition, legislation enacted in California in 2014 increased that state's annual tax credit cap from \$100.0 million to \$330.0 million in an effort to keep productions in that state.

State Subsidies Have Increased Significantly Over Time

As more states have offered film production incentives, the costs of these incentives to states have risen dramatically, as seen in **Exhibit 1.4**. In 2002, states provided approximately \$1 million in various state film production incentives, but by 2010 these state incentives peaked at approximately \$1.4 billion. This escalation reflects both the increase in the number of states offering incentives and an increase in the generosity of programs as states tried to remain competitive with each other. The cost of attracting film productions increased each year as states tried to outdo one another. For example, the Pennsylvania Film Office allocated \$487,000 to attracting film productions in 2000. In 2004, Pennsylvania established a state film incentive program and began allocating \$10 million annually, substantially less than the current \$60 million annual cap. New York is another example of a state that has also escalated program funding – New York provided a maximum of \$25 million in tax credits in 2005, increasing to over \$400 million in 2014.

Exhibit 1.4
Total State Film Incentives
Calendar 2002-2011
(\$ in Millions)

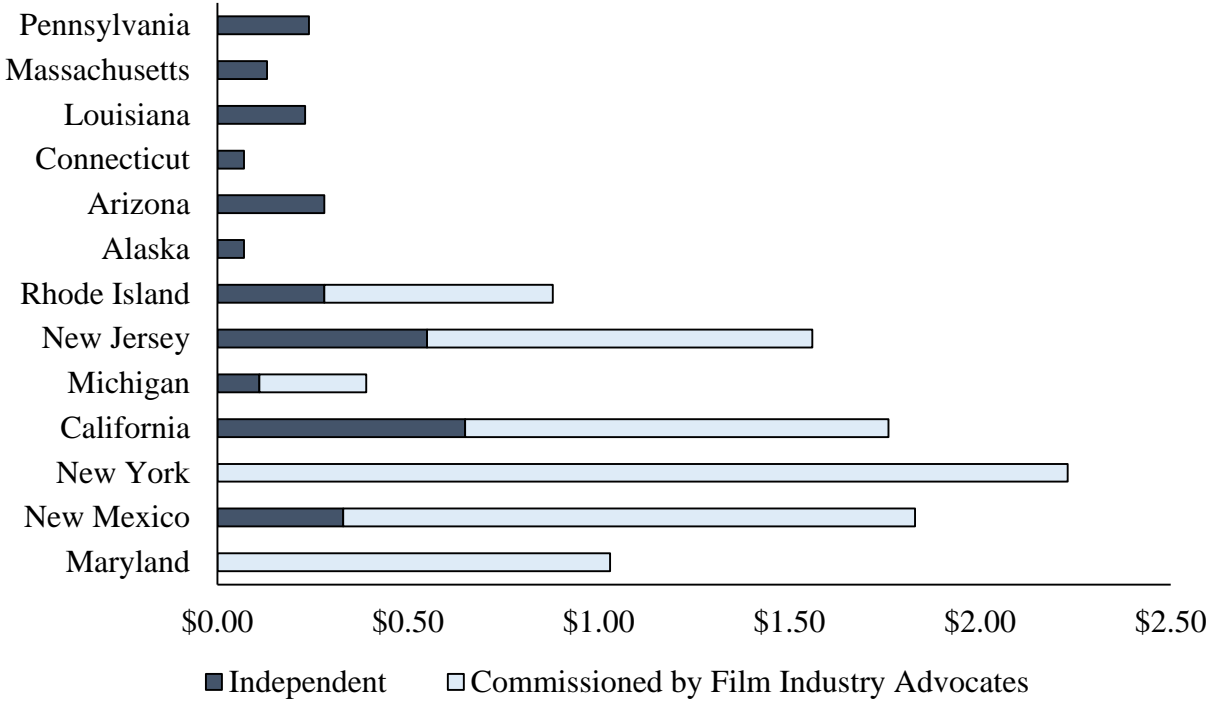


Source: Tax Foundation

Are Film Production Incentives Effective?

Among the reasons given by most states for offering film production incentives are economic development, job creation, and tourism. While film productions can contribute dollars to local economies in the form of wages and spending on local goods and services, there are questions as to how much the states get back in the form of additional tax revenues, compared to what they spend on incentives. Film industry advocates typically show a positive ROI; states receive more in tax revenues than they pay in film incentives. However, studies performed by independent entities typically find a much lower ROI. Most studies by independent state agencies have found that the ROI to the state was less than 50 cents for every dollar spent on film incentives. For example, a 2013 study conducted by the Massachusetts Department of Revenue estimated that Massachusetts received only 13 cents in tax revenues for each dollar it spent on film production incentives. **Exhibit 1.5** compares the ROI as calculated by independent agencies to those commissioned by film industry advocates.

Exhibit 1.5
Film Production Incentives
Return to State for \$1 Spent on Incentives
As Calculated by Independent Entities and the Film Industry Advocates



Source: State Legislative, Economic Development, and Treasury Departments; Department of Legislative Services

Exhibit 1.6 shows the ROI and the cost per job of incentives in various states, as calculated by independent state agencies. Most states have an ROI of under 50 cents, while the cost per job varies significantly among the states, ranging from a low of \$8,519 in New Mexico to a high of \$128,575 in Massachusetts.

Exhibit 1.6
Return on Investment and Cost per Job of Various State Film Credits

<u>State</u>	<u>Year</u>	<u>Return on Investment*</u>	<u>Cost Per Job</u>
Alaska	2012	\$0.07	\$56,600
Arizona	2009	0.28	23,676
Connecticut	2008	0.07	33,400
Louisiana	2013	0.23	12,005
Louisiana	2009	0.13	16,100
Louisiana	2005	0.18	14,100
Massachusetts	2013	0.13	128,575
Michigan	2010	0.11	44,561
New Jersey	2011	0.55	10,953
New Mexico	2008	0.14	13,400
New Mexico	2014	0.33	8,519
North Carolina	2013		30,300
Pennsylvania	2009	0.24	13,000
Rhode Island	2008	0.28	

*Return on investment is amount of revenue generated per \$1 of state incentive.

Source: State Legislative, Economic Development, and Treasury Departments; Department of Legislative Services

Findings from studies commissioned by film industry advocates typically vary from those performed by independent entities because of different assumptions made in their analyses. Studies commissioned by film industry advocates do not always account for a state's balanced budget requirement and nonresident activity such as employment of out-of-state actors and filmmakers. Some studies account for local revenues while others do not. Additionally, some studies make questionable assumptions when calculating the economic impacts of film tourism in a state. A common theme of studies commissioned by film industry advocates is a lack of detail surrounding the methodology used to determine estimates.

Film Production Incentives in Maryland and Surrounding States

As noted previously, 37 states and the District of Columbia currently offer some sort of film production incentive. **Exhibit 1.7** shows the major characteristics of Maryland's tax credit program compared to those in the surrounding states as of May 2014. Maryland, North Carolina (prior to January 2015), and Virginia provide refundable tax credits. New Jersey, Pennsylvania,

and West Virginia have transferable tax credits. Delaware is the only surrounding state that does not currently provide any type of film production incentive. Virginia established an incentive program in 2001, but the program was not funded on a regular basis until 2006. Pennsylvania and New Jersey were next to establish incentive programs in 2004 and 2005, respectively. Maryland established an employer wage rebate program in fiscal 2006, converting it to a Film Production Rebate Program in fiscal 2008, and to a film production activity tax credit beginning in fiscal 2012.

Of Maryland's nearby states, North Carolina has had the most generous tax incentive program in recent years, with no annual cap on the total amount of tax credits that may be claimed. However, North Carolina eliminated its existing tax credit program on January 1, 2015, and replaced it with a \$10 million annual grant program. Pennsylvania also has a very generous tax credit program, as approximately \$243 million in state tax credits have been approved for film production companies since 2004.

Maryland has the next highest annual cap in fiscal 2014 at \$25.0 million, followed by New Jersey with a \$10.0 million annual cap. Virginia has a biennial budget with a total biennial cap on incentives of \$5.0 million for fiscal 2013 and 2014. Virginia's annual tax credit report indicates that there were no claims during the first year of the credit (fiscal 2011). However, the amount of credits issued in fiscal 2012 are not available due to taxpayer confidentiality requirements. West Virginia also has a \$5.0 million annual cap and issued \$903,645 in tax credits for fiscal 2011, \$2.8 million in fiscal 2012, and \$1.5 million for fiscal 2013, although the amount for fiscal 2013 has not yet been finalized.

The District of Columbia provides its film production incentives in the form of a rebate to production companies. The District Film Office advises that in fiscal 2014, the grant money was moved to other city programs and there were no film production incentives provided during the fiscal year. There is just under \$3 million in the incentive fund for fiscal 2015, but the policies for disbursement of funds are currently under review.

Exhibit 1.7
Film Production Tax Incentives in Maryland and Surrounding States
As of May 2014

<u>State</u>	<u>Incentive</u>	<u>Refundable/ Transferable</u>	<u>Maximum Benefit*</u>	<u>Minimum Spend</u>	<u>Compensation Cap</u>	<u>Per Project Cap</u>	<u>Annual Cap</u>	<u>Date Established</u>
District of Columbia	Rebate		42%	\$250,000			\$4,000,000	2007
New Jersey	Credit	Transferable	20%				10,000,000	2005
North Carolina ¹	Credit	Refundable	25%	250,000	\$1,000,000	\$20,000,000		2006
Pennsylvania	Credit	Transferable	30%		15,000,000	12,000,000	60,000,000	2004
Virginia	Credit & Grant	Refundable	40%	250,000	1,000,000		5,000,000	2001
West Virginia	Credit	Transferable	31%	25,000			5,000,000	2007
Maryland	Credit	Refundable	25%/27%	\$500,000	\$500,000		\$25,000,000	2008

*Maximum benefit is generally the percentage of eligible production expenditures that qualify for the credit.

¹On January 1, 2015, North Carolina converted to a competitive grant program with a \$10 million funding limit.

Source: State Legislative, Economic Development, and Treasury Departments; National Conference of State Legislatures; Department of Legislative Services

Maryland Film Incentives

The Maryland Film Office within DBED markets the State to the film industry and works with production entities to facilitate the process of film production. Beginning in 2001, Maryland augmented these efforts with financial assistance in an effort to further encourage film production activities in the State. The evolution of these programs closely follows the national experience of increased subsidies over time as the Maryland Film Office determined that additional funding was required to stay competitive with other states' programs. The first program, a sales and use tax exemption, was followed by subsequent programs that provided a rebate or tax credit based on expenses, increasing the amount of financial assistance provided to the film industry due to concerns that other states and countries were offering better incentives and drawing productions away from the State. As the State programs paid for an increasing portion of an entity's qualified production activities, fiscal costs increased and the ratio of production expenses to State financial assistance, or net benefit to the State, decreased significantly. To date, a total of \$99.2 million in tax credits, rebates, and exemptions have been provided or committed by these programs since fiscal 2001.

Sales and Use Tax Exemption

Chapter 432 of 2000 established a sales and use tax exemption for qualified film production activities. The intent of the legislation, introduced at the request of DBED, was to increase film production activity in the State, bringing economic benefits to citizens of the State and generating increased employment opportunities. A broad range of activities qualify for the exemption and includes the (1) production or post production of film or video projects including feature films, television projects, commercials, corporate films, infomercials, music videos or (2) other projects for which the producer or production company will be compensated, and that are intended for nationwide distribution. The exemption applies to tangible personal property or a taxable service and includes items such as film, camera equipment, vehicle rentals, lighting and stage equipment, and props. The film producer or production company must apply to DBED for certification of eligibility for the exemption. DBED issues certificates to entities filming in Maryland, and these certificates exempt from the sales and use tax qualified purchases of goods or services.

Since 2001, DBED has issued 1,053 sales and use tax exemption certificates totaling \$17.8 million. Although most of the qualified activity, and foregone sales and use tax revenue, is the result of television series production, other activities have also claimed the sales and use tax exemption. For example, DBED has awarded, since fiscal 2010, a total of 191 exemptions resulting in an estimated \$10.9 million in foregone sales and use tax revenue. DBED issued the most exemptions for the production of commercials (112), many for local businesses; followed by television series (32); films (24); documentaries (9); public service announcements (8); and industrial films/company safety films (6). Most of the activity and foregone tax revenue was generated by TV series (\$9.4 million), followed by commercials (\$1.1 million), and film production (\$356,700). **Exhibit 1.8** provides the total and eligible film production activity expenditures spent in the State since fiscal 2001 and the total amount of foregone sales and use tax revenue in each year.

Exhibit 1.8
Maryland Film Production Activity
Sales and Use Tax Exemption
Fiscal 2001-2014

<u>Fiscal Year</u>	<u>Total Maryland Film Production Activity</u>	<u>Total Eligible Film Production Activity</u>	<u>Forgone Sales and Use Tax Revenue</u>
2001	\$20,281,900	\$11,470,400	\$573,500
2002	32,988,500	15,896,400	794,800
2003	64,663,100	20,119,700	1,006,000
2004	65,318,900	19,924,800	996,200
2005	20,392,800	14,273,000	713,600
2006	74,151,400	32,775,100	1,638,800
2007	40,845,600	18,279,800	914,000
2008	27,394,200	9,686,900	581,200
2009	19,231,000	6,422,000	385,300
2010	20,186,300	7,827,400	430,500
2011	31,134,400	6,775,400	406,500
2012	68,782,900	31,162,100	1,713,900
2013	116,479,400	66,315,800	3,978,900
2014	117,461,600	66,483,800	3,656,600
Total	\$719,312,000	\$327,412,600	\$17,789,800

Source: Department of Business and Economic Development

Film Production Employer Wage Rebate Program

According to the Maryland Film Office, major motion picture studios repeatedly advised during the 2000s that states with film incentive programs were considered as viable film production options, while those without incentives were not. In response to concerns that Maryland did not offer incentives and productions were being “lost” to other jurisdictions, Chapters 96 and 97 of 2005 established the Maryland Film Production Employer Rebate program. The primary goal of the program was to retain the film industry in Maryland by offering a partial rebate of locally paid wages, thereby encouraging film production and the employment of local film crews. The program allowed qualified film, television, or commercial producers engaging in film production activity in the State a rebate of 50% of the first \$25,000 of each qualified employee’s wages, up to a maximum of \$2 million for each production. To qualify for the rebate, a film production had to be intended for nationwide distribution and have direct costs in the State of at least \$500,000. The amount of rebates were subject to an annual State budget appropriation beginning in fiscal 2006.

Chapters 96 and 97 required DBED to annually report specified information about the program. In its interim report issued in January 2006, DBED noted that competition for film activity continued to be fierce both domestically and abroad – since the 2005 legislative session, 10 states had passed or enhanced incentive programs, most with high or no per project limits or unlimited annual funding, bringing to 25 the number of states offering film production subsidies. The report also cites several specific state programs as offering aggressive financial incentives, including New York (10% credit and \$25.0 million overall limit, with an additional New York City program), Massachusetts (20% payroll, 25% production, and \$7.0 million per project limit), Louisiana (20% payroll and 15% production), and North Carolina (15% and \$7.5 million per project limit). In response to the increased competition, Canada also increased the value of its incentive from 5% to 10% of qualified expenses. The report also determined that production incentives had now become the industry norm and the foremost criterion used in determining a film location. The report stated that if Maryland lacked adequate funding, productions would locate in competing states that offered significant incentives.

In fiscal 2006, the program provided \$4.0 million in rebates to three productions with total Maryland direct expenditures of \$37.6 million, including the hiring of 1,046 local crew members and payments to 1,352 local vendors. Of the amount appropriated in fiscal 2007, the Maryland Film Office provided two rebates totaling \$2.3 million to productions with total direct expenditures of \$15.6 million, some of which occurred during fiscal 2008. Although the rebates provided in fiscal 2007 were not as cost effective as in the prior year, DBED provided a total of \$6.3 million to five productions over the two fiscal years for an average grant of about \$1.3 million, or 11.9%, of the total direct expenditures of \$53.2 million.

DBED's December 2007 annual report stated that "after 20 months of administering the program DBED realized that its incentive was not attracting large scale projects due to cap restrictions. As more states enacted incentive programs with large or no per project cap, Maryland's incentive was unable to draw interest from the industry." Further, the report stated that Maryland was the only state using an incentive based solely on wages. DBED stated that a more generous incentive program was necessary, and that doing so would help the State target films with large production budgets. Chapter 87 of 2007 altered the value of the subsidy received by a production entity from a rebate of 50% of the first \$25,000 of each qualified employee's wages, to a maximum of 25% of the direct costs of the film production activity. This did not apply to employees earning over \$1 million. Chapter 87 also removed the \$2 million maximum grant and provided that the actual amount disbursed is at the discretion of DBED.

A subsequent report noted that there was a "flurry" of film activity in response to the new production incentive rebate program. Of the amount appropriated to the wage rebate fund in fiscal 2007, DBED used \$4,575,000 in fiscal 2008 to provide rebates under the new program in addition to \$4.0 million appropriated to the fund in each of fiscal 2008 and 2009. However, the impacts of the recession worsened, requiring the State to reduce spending to balance the budget. The Board of Public Works (BPW) reduced the fiscal 2009 appropriation by \$1.5 million, but DBED was allowed to use a \$1.0 million fiscal 2007 grant offer that had been rescinded. In fiscal 2010 and 2011, \$1.0 million was appropriated each year, with another cost containment

reduction of \$453,000 in fiscal 2010. From fiscal 2008 to 2011, DBED awarded \$12.6 million in grants to 14 productions with a total direct spend of \$55.6 million. Compared to the wage rebate program, funding limitations reduced the average grant to \$901,600, which also resulted in smaller-scale productions. Rebates over this period comprised 22.7% of the total direct expenditures of \$55.6 million.

During the 2009 session, the Senate Budget and Taxation and the House Appropriations committees requested that DBED convene a stakeholder workgroup to review (1) the existing Maryland program; (2) programs in other states; and (3) the status of the State's film and video production industry. DBED was required to report the workgroup findings and include recommendations for legislation to modify or replace the existing rebate program if the current program was found to be not effective in attracting and retaining film and television production.

The workgroup issued its report in January 2010. The report noted that the rebate program had been "demonstrably effective in the past" but changes were needed in light of the prevalence and funding of state incentive programs. The workgroup found that the problem was not with the structure of the program but with a lack of sufficient funding. The program would be most effective without an annual funding cap, or with a relatively high annual cap. Specifically, the workgroup recommended (1) maintaining the existing structure of the program; (2) continuing to provide the Maryland Film Office with considerable discretion to negotiate with film and television series; (3) creating an enhanced incentive of 27% specifically targeting television series production; and (4) providing a \$15.0 million annual appropriation to the program. The workgroup noted that this amount should be sufficient relative to funding levels in nearby states, including West Virginia and New Jersey (\$10.0 million each), Pennsylvania (\$42.0 million), and the uncapped Georgia and North Carolina programs. The report cited Rhode Island's program, funded at \$15.0 million, as an effective model that would be sufficient to enable Maryland to effectively compete and attract a television series and/or several feature films each year.

Exhibit 1.9 shows the total amount appropriated to the Film Production Wage Rebate Program in each fiscal year and the net amount awarded after BPW cost containment actions and transfers.

Exhibit 1.9
Film Rebate Program Funding
Fiscal 2006-2011

<u>Fiscal Year</u>	<u>Appropriation</u>	<u>Reduction</u>	<u>Net Amount</u>
2006	\$4,000,000	\$0	\$4,000,000
2007	6,875,000	-1,000,000	5,875,000
2008	4,000,000	0	4,000,000
2009	4,000,000	-500,000	3,500,000
2010	1,000,000	-453,000	547,000
2011	1,000,000	0	1,000,000
Total	\$20,875,000	-\$1,953,000	\$18,922,000

Source: Department of Business and Economic Development; Department of Legislative Services

Film Production Activity Tax Credit

Credit Amounts, Eligibility, and Certification

Chapter 516 of 2011 converted the existing Film Production Rebate Program to the Film Production Activity Tax Credit and authorized DBED to annually award a maximum of \$7.5 million in credits in fiscal 2012 through 2014, with a termination date of July 1, 2014.

DBED administers the tax credit, and the Maryland Film Office within DBED is tasked with attracting films and video productions to the State. A film production entity may receive a refundable tax credit of up to 25% of the qualified direct costs of a film production activity. A television series may receive an enhanced credit of up to 27% of qualified direct costs. In order to qualify, the production entity must (1) be able to demonstrate complete financing; (2) show an acceptable level of national distribution; (3) conduct at least one-half of the principal photography in the State; and (4) estimate that the total projected qualified direct costs incurred in the State exceed \$500,000. Total qualified direct costs may not include any salary, wages, or “other compensation” of an individual who receives more than \$500,000 for personal services in connection with the production activity. Qualified direct costs must be prorated based on the time personnel or materials are in Maryland and may not include costs associated with filming outside of Maryland.

A production entity must first submit an application for preliminary tax credit certification. An applicant is required to provide information about (1) the applicant’s legal formation; (2) the type of production; (3) the estimated production budget; (4) the anticipated production schedule; and (5) estimated state of residence of the production crew. The application includes an addendum

that requires the applicant to make certain certifications. Prior to the start of principal photography in the State, a form for additional documentation and information must be filed providing more detailed information about the production entity and its chief officers.

Within 30 days of receiving a completed application, DBED must issue a (1) preliminary tax credit certificate; (2) letter of intent specifying the qualified tax credit amount and the fiscal year in which the funds will be drawn; or (3) notice that the production entity is ineligible for a tax credit. The credit amount specified on the preliminary tax credit certificate or in the letter of intent is the maximum tax credit for which the applicant is eligible for this film production activity. Generally, principal photography must begin within 120 days of the preliminary tax credit certificate or the letter of intent.

An application for final tax credit certification must be submitted to DBED along with all required final documentation within 180 days after the production's completion date including documentation on the employees and payroll, a general ledger and accounts payable list, a list of all employees in the State, and other specified information. An independent third-party certified public accountant produces an independent auditor's report that is submitted for review with the application for final tax credit certification.

The Maryland Film Office reviews for completeness and accuracy the application for final tax credit certification, all closing documentation, and the independent auditor's report. Based on the actual qualified total direct costs and the auditor's report, DBED will issue a final tax credit certificate to the production entity, which may not exceed the tax credit amount specified in the preliminary tax credit certificate or original letter of intent.

The production entity may claim a credit against the State income tax in an amount equal to the amount stated in the final tax credit certificate. If the tax credit allowed in any taxable year exceeds the total tax otherwise payable by the qualified production entity for that taxable year, the qualified production entity may claim a refund in the amount of excess. In order to claim the credit, the production entity must file the applicable Maryland income tax return, and must attach a copy of the final certificate issued by DBED along with Form 500CR, Maryland Business Income Tax Credits.

In the first six months of the program (July-December 2011), four production companies applied for and were qualified by DBED to receive a tax credit, thereby committing all funds allocated for the tax credit through fiscal 2014. Those projects were for the first and second seasons of the HBO series *VEEP*, season 1 of the Netflix series *House of Cards*, and two independent films – *Better Living Through Chemistry* and *Jamesy Boy*.

Since the credit's inception, legislation has been introduced in each session proposing to increase the maximum allocation of credits. During the 2012 session, the Senate passed legislation increasing the amount of film tax credits that DBED could authorize in each fiscal year. Senate Bill 1066 increased, from \$7.5 million to \$22.5 million, the total amount of credits DBED could award in each fiscal year. In their written testimony on the bill, DBED stated that there were

two television series being produced in the State (*VEEP* and *House of Cards*) and that in the absence of additional funding, these productions would relocate elsewhere. While the legislation passed the Senate unanimously, no further action was taken by the House Ways and Means Committee.

While *VEEP* and *House of Cards* did not leave the State after the 2012 session, out of concern that those productions might leave in the future, DBED requested the introduction of legislation during the 2013 session to increase the amount of film tax credits that it could authorize. Chapter 28 of 2013 increased from \$7.5 million to \$25.0 million the total amount of tax credits that DBED could award in fiscal 2014 and extended the termination date of the credit by two years to July 1, 2016. All of the tax credits authorized under Chapter 28 were committed by the end of the first day DBED began accepting applications.

During the 2014 legislative session, legislation was introduced to increase the amount of film tax credits that could be authorized in fiscal 2015. At the request of DBED, House Bill 520 of 2014 would have increased from \$7.5 million to \$11.0 million the total amount of tax credits DBED could award in fiscal 2015. This proposed increase, however, was less than the total amount of credits *House of Cards* could claim for production of its third season if sufficient funding was available. Senate Bill 1051 of 2014 would have increased from \$7.5 million to \$18.5 million the total amount of tax credits DBED could award in fiscal 2015, which would satisfy the total amount of credits for *House of Cards*.

In the midst of the 2014 legislative session, Media Rights Capital, (MRC), the company producing *House of Cards*, sent a letter to the Governor and Presiding Officers of the General Assembly addressing the 2014 legislation proposing to provide additional tax credits. The letter indicated that although MRC and *House of Cards* had a wonderful experience over the past two seasons and wanted to stay in Maryland, the production entity was “required to look at other states in which to film on the off chance the legislation did not pass, or did not cover the amount of tax credits for which we would qualify.” Further, MRC advised it had planned to begin filming in early spring but decided to “push back the start date for filming until June to ensure there has been a positive outcome of the legislation.” In the event sufficient incentives did not become available, MRC advised it would “break down our stage, sets, and offices and set up in another state.” A full copy of the letter can be found in **Appendix 1**.

While the General Assembly ultimately did not pass legislation that increased the amount of tax credits, Chapter 464 of 2014 authorized the use of \$2.5 million from the Special Fund for Preservation of Cultural Arts in Maryland and \$5.0 million from the Economic Development Opportunities Program Account (Sunny Day Fund) for grants to supplement tax credits in fiscal 2015. Under current law, \$7.5 million in tax credits are authorized in fiscal 2016. **Exhibit 1.10** shows the amount of funding provided to the program by Chapter 516 of 2011 as well as the additional funding provided by legislation enacted in 2013 and 2014.

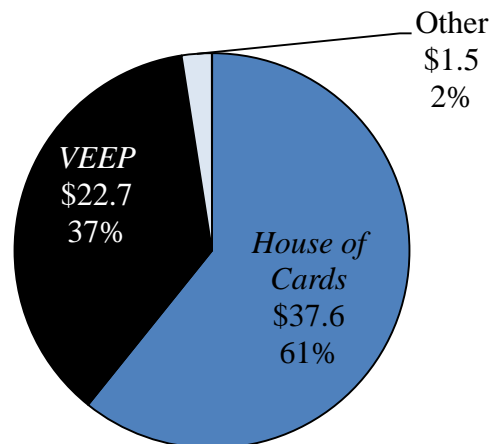
Exhibit 1.10
Film Production Activity Tax Credit Funding
Fiscal 2012-2016
(\$ in Millions)

<u>Legislation</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Total</u>
Ch. 516 of 2011	\$7.5	\$7.5	\$7.5	\$0	\$0	\$22.5
Ch. 28 of 2013	0	0	17.5	7.5	7.5	32.5
Ch. 464 of 2014	0	0	0	7.5	0	7.5
Total	\$7.5	\$7.5	\$25.0	\$15.0	\$7.5	\$62.5

Source: Department of Legislative Services

DBED has awarded or committed a total of \$61.8 million of the total funding provided in tax credits in fiscal 2012 through 2016. While a total of 10 productions, and 5 production entities, have claimed the film tax credit, the production entities for *House of Cards* and *VEEP* have dominated the tax credit allocations. *House of Cards* has been allotted a total of \$37.6 million, while *VEEP* has received \$22.7 million. In addition, the *VEEP* pilot also received a production rebate of \$782,319 in fiscal 2011, the last year of the program. **Exhibit 1.11** shows the distribution of the tax credits by production.

Exhibit 1.11
Distribution of Maryland Film Production Activity Tax Credits
Fiscal 2012-2016
(\$ in Millions)



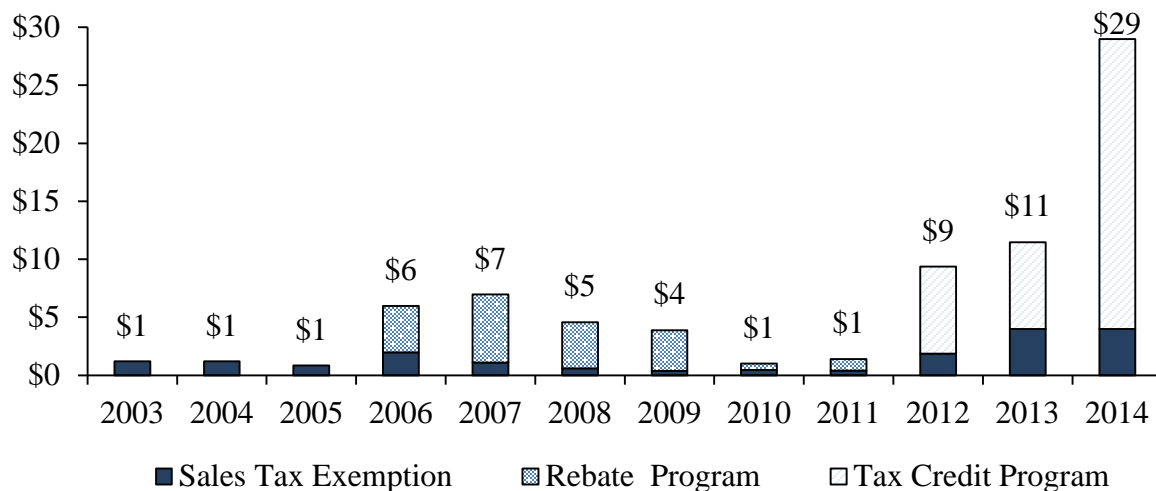
Source: Department of Business and Economic Development

State and Local Revenue Impacts

The Film Production Activity Tax Credit Program has been funded at a higher annual amount than the prior production rebate programs. A total of \$61.8 million in credits have been committed to 10 productions with total expenditures of \$274.2 million. Both the average incentive (\$6.2 million) and production expenditures (\$27.4 million) are greater than under the production rebate program. As a percentage of total expenditures, the tax credit program has provided a similar percentage of credits, 22.5%, as provided by the production rebate program.

As the film incentive programs have evolved, the total amount of productions and fiscal costs have both increased. **Exhibit 1.12** shows, through fiscal 2014, the total annual amount of incentives awarded under the sales and use tax exemption, production/wage rebate programs, and tax credit.

Exhibit 1.12
Total Maryland Film Incentives
Fiscal 2003-2014
(\$ in Millions)



Source: Department of Business and Economic Development; Department of Legislative Services

State Impact

Legislation enacted from 2011 to 2014 authorized DBED to award a maximum of \$62.5 million in film production activity tax credits in fiscal 2012 through 2016, as shown in Exhibit 1.10. As of September 2014, DBED has issued \$61.8 million, with \$683,773 remaining unallocated. DBED advises it anticipates issuing the remaining unallocated funds. Tax credits could first be claimed beginning for tax year 2012. Entities generally receive final certification in

the year after a qualified production activity ends. The amount of final credit certificates issued by DBED has increased over time, growing from \$3.4 million in calendar 2012 to \$13.2 million in calendar 2013, and peaking at \$27.3 million in calendar 2014. Based on projected filming dates, DBED anticipates issuing an additional \$10.5 million in calendar 2015 and \$7.4 million in calendar 2016.

The Comptroller's Office does not yet have complete information on credits that have been claimed since calendar 2012. As such, it is unknown how many credits have been claimed by productions against the corporate income tax versus the individual income tax (as a pass-through entity) or the year in which the tax credit will be claimed. DLS assumes credits are claimed in the year in which DBED issues the final credit certification. The exact timing of the revenue losses is not known, but State revenues will decrease by a total of \$61.8 million between fiscal 2013 and 2017.

Based on preliminary data, the Comptroller's Office estimates that film production activity tax credits are becoming a major source of corporate income tax refunds. In fiscal 2014, the Comptroller's Office issued a total of \$42.0 million in total corporate income tax refunds, which includes refunds for any purpose including tax credits and overpayments. Of these refunds, the Comptroller's Office estimates that it issued \$11.0 million in film production credit refunds. Production activity credit claims have significantly increased in fiscal 2015 – totaling \$19.8 million or about one-third of all corporate tax refunds issued to date.

State general fund revenues decrease due to any claims against the personal income tax, and most of the credits claimed against the corporate income tax also reduce general funds. Credits claimed against the corporate income tax also reduce revenues distributed to the Higher Education Investment Fund and the Transportation Trust Fund.

DBED estimates that it incurs approximately \$45,000 in annual tax credit administrative costs. Currently, two staff devote a portion of their time administering and overseeing the credit. Their job responsibilities include:

- communicating with production personnel and studio executives;
- responding to tax credit questions;
- discussing the legalities of the credit with the Attorney General's Office;
- coordinating tax credit information with the Comptroller's Office;
- preparing mandated legislative reports;
- providing tax credit data to StateStat and Salesforce;

- maintaining tax credit databases, forms, and website information; and
- reviewing tax credit applications.

Local Impact

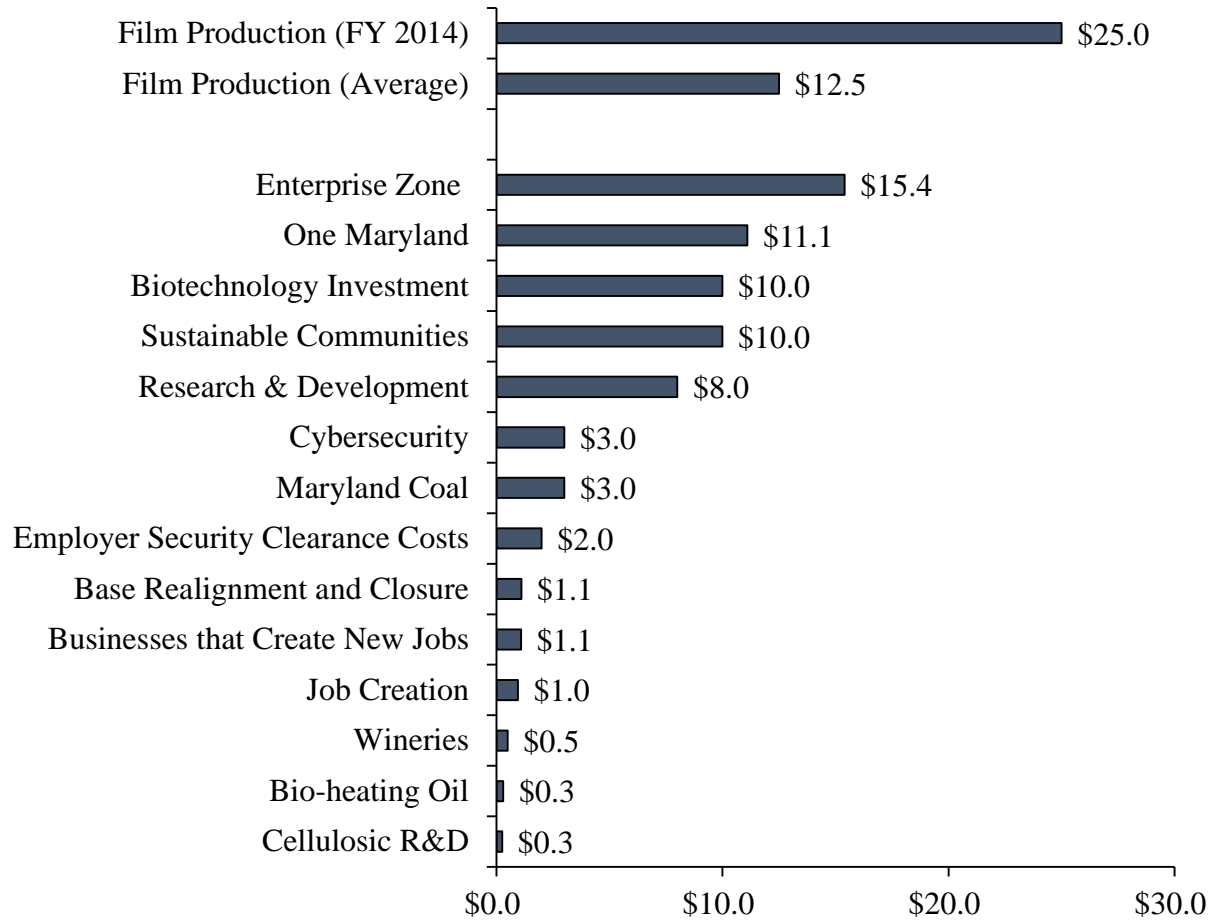
Local governments receive a portion of corporate income tax revenues to support the construction and maintenance of local roads and other transportation facilities. Credits claimed against the corporate income tax will result in a decrease in local highway user revenues.

Film Tax Credit Funding Compared to Other State Business Tax Credits

The fiscal 2014 film production funding, \$25.0 million, was a significant increase over the initial \$7.5 million provided in each of fiscal 2012 and 2013. The amount provided decreases to \$15.0 million in fiscal 2015 and \$7.5 million in fiscal 2016. The Maryland Film Office advises that the fiscal 2014 program funding, \$25.0 million, and the percentage value of the credit, are the minimum amounts necessary to maintain a viable program. This assessment is not based on an analysis of the credit's optimal economic benefits or cost effectiveness, but reflects the amount necessary to compete with other state incentive programs. The fiscal 2014 funding also paid for a portion of the expenditures associated with several seasons of *VEEP* and *House of Cards*. On average, the program has received \$12.5 million in funding in each year through fiscal 2016.

Exhibit 1.13 shows the amount of film production credits provided in fiscal 2014, and the average annual amount of funding from fiscal 2012 through 2016 compared to other business tax credits. The film production activity tax credit has the largest State fiscal impact of any business tax credit in fiscal 2014. The Enterprise Zone program has the next largest State fiscal impact, but the program is larger if local costs are included, as the State reimburses local governments for one-half of the property tax credit provided by the program. The average amount provided to the film production activity tax credit program, \$12.5 million, is greater than the fiscal 2014 funding provided to the biotechnology incentive, sustainable communities, and research and development tax credits.

Exhibit 1.13
Comparison of State Business Tax Credit Allocations
 (\$ in Millions)



Note: Amounts shown above reflect fiscal 2014 appropriations or tax year 2013 limits for tax credits subject to annual limitations. Tax credit data for credits without limits is not available, amounts shown are forecasted based on recent average claims.

Source: Department of Legislative Services

Chapter 2. Intent and Objectives

Chapter 516 of 2011 established the film production activity tax credit, but did not specify a specific goal or intent for the credit. The Maryland Film Office advises the intent is to encourage film production in the State and promote economic development. Although Chapter 516 did not specify a specific intent or goal, the legislation's preamble enumerated 12 findings related to film tax incentives. The key findings include:

- significant amounts of State and local tax revenues are generated by the economic activity created from producing films in Maryland;
- key decision makers in the movie industry have demonstrated a preference for and commitment to making movies in the State;
- the scope of film production activity is broad and diverse resulting in substantial expenditures within a state on local companies and businesses that become a part of the film production activity;
- long-term benefits include development and establishment of spin-off activities such as editing; sound production; creative and artistic activities; and development of permanent facilities such as soundstages, studios, and cottage industries related to movie making; and
- the Governor and the General Assembly find and declare that the net benefit to Maryland as a result of this increased economic activity is positive and is necessary for strengthening the State's economic condition.

Rationale for Government Intervention

The United States is a modern market economy as most goods and services are produced by the private market. Markets provide optimal benefits to society when economic activity and resources are allocated efficiently. This efficient allocation depends on several conditions including free competition and a clear assignment of prices and benefits. Although most goods and services in the United States are supplied by the private market, governments intervene in many markets by either supplying the good or service or causing different outcomes than that produced by the private market alone.

Market failures occur when the private market does not produce the most efficient outcome for society. For example, the private market may not incorporate all of the activity's costs and benefits to society. If the activity has additional benefits to society, such as health care or education, markets may under-produce the good compared to the socially optimal quantity. A recent U.S. Federal Reserve analysis noted that in the midst of the recent financial meltdown and

resulting recession, few people are left unconvinced of the possibility of market failures. Governments can intervene in a variety of ways – through regulation, taxation, and/or subsidies. Subsidies are a form of government assistance to a subset of the public that lowers the cost of producing a good or the price that a consumer pays for a good. While tax credits are a form of subsidies provided through the tax code, subsidies can also be delivered via regulation and direct provision.

Most analysts believe that although markets can fail, there should be an expectation that government intervention can improve outcomes before any action is taken. Poorly designed policies can result in society being worse off. For example, most economists believe that although there were market failures within the U.S. housing industry, poorly designed policies including subsidies contributed to the housing market implosion. Policy analysts typically identify two rationales for how subsidies can improve free-market outcomes:

- **Efficiency:** Subsidies can correct the failure of the market to produce the efficient amount of goods and services, thereby improving societal benefits; and
- **Outcomes:** Markets can operate efficiently, but produce outcomes that are deemed inequitable – for example, private market activities can result in unacceptable levels of poverty and joblessness.

Other State Tax Credits Clearly Identify an Outcome or Efficiency Goal

The Department of Legislative Services (DLS) reviewed the intent of numerous current and recently expired State business tax credits. For the vast majority of these credits, DLS could identify a valid efficiency or outcome goal specified in the legislation creating the tax credit, supported by economic theory, or found in a similar federal program. For example, the research and development tax credit provides tax credits for a firm's qualified research expenses. Economists believe that firms may not produce the optimal amount of research as the benefits to society, through spillover effects, are greater than the private gain to the firm. In the absence of credits, firms will produce less than the efficient amount of research. The goal of four business tax credits – enterprise zone, community investment, employment opportunity, and one Maryland – is to change market outcomes, specifically, that the market produces areas of poverty and economic distress. In addition, the goal of the State's largest tax credit, the earned income credit, is to alleviate poverty.

Most tax credits can be claimed by firms in many different industries. There are several tax credits that target specific industries, like the film production activity tax credit; unlike the film tax credit, however, there are underlying efficiency goals for these other credits. The biotechnology and cybersecurity investment incentive credits seek to increase investment in qualified Maryland companies. Capital markets may not be efficient and provide capital to companies with promising research. In addition, these tax credits also aim to capitalize on

Maryland's advantages, such as proximity to the District of Columbia, and promote clustering. Some analysts believe that clustering can promote efficiencies as a group of firms, and related economic actors and institutions that are located near one another can draw productive advantage from their mutual proximity and connections. It should be noted that film production activity tax credits enacted by states have had the opposite effect, drawing productions away from clusters centered in New York and California. **Exhibit 2.1** shows the underlying outcome and efficiency goals of several State business tax credits. In some cases, tax credits have both goals. Although the goals of these tax credits may be valid, DLS has questioned whether these programs efficiently achieve their goals, most recently in the evaluations of the enterprise zone and one Maryland tax credits.

In contrast to other business tax credits, the film production activity tax credit does not clearly identify an efficiency or outcome goal in its intent. The preamble of Chapter 516 of 2011 concludes that the net benefit to Maryland from the program is positive, implying that the program achieves an efficiency goal. However, it is not sufficient to simply show that the subsidy delivers some positive benefits, but whether it provides the benefit in a cost-effective manner and with greater economic benefits than other policies.

Exhibit 2.1
Goals and Outcomes for Various State Business Tax Credits

Tax Credit Program**Program Goal****Efficiency**

Job Creation

Increase employment and economic growth, reduce negative impacts of unemployment

Biotechnology Investment

Capital markets may not be efficient and provide capital to start ups with promising research

Clean Energy/Electric Vehicle

Promote energy independence and clean technologies that may have fewer negative environmental impacts than conventional energy sources

Cybersecurity Investment

Promote investment in emerging industry and provide incentive to cluster in Maryland

Sustainable Communities

Private market may not value historic structures; dilapidated buildings may negatively impact surrounding neighborhood

Promote efficient land use by promoting development within areas with adequate infrastructure

Research and Development

Gains to economy and society from research are greater than private gain realized by company conducting research

Security Clearance – Employer Costs

Promote clustering in Maryland; promote employment by lowering industry employment costs

Outcomes

Community Investment

Promote community development in distressed areas

Enterprise Zone

Promote economic development within distressed areas and employment of community residents

Reduce areas of concentrated poverty which impose additional costs on individuals

Employment Opportunity

Employment opportunities for low-income individuals may be limited – reduce State social safety net costs by increasing employment.

One Maryland

Promote employment and capital investments within distressed areas

Long-Term Employment of Ex-felons

Promote employment opportunities for ex-felons – reduce recidivism and future State costs

Maryland Disability Employment

Private market may provide limited opportunities for individuals with disabilities

Source: Department of Legislative Services

Chapter 3. Economic Impacts

Analyzing the true economic impact of a tax credit requires isolating the impact of the credit from other factors that influence the business undertaking the qualifying activity. This approach will provide an estimate of how much economic activity resulted solely from the credit and was not due to other factors or that would have occurred even without receipt of the tax credit. An additional step requires an estimate of the net impact to State revenues – the cost of foregone revenue plus any additional State revenue that was generated by economic activity that would not have occurred without the credit. Since the Governor is required to submit a balanced budget every year, revenue that is foregone under the credit requires either a corresponding reduction in State spending or an increase in revenue from individuals or businesses, both of which dampen economic activity. Lastly, any spillover impacts should be captured. Positive spillover impacts include a business using the reduction in taxes to increase production and purchase additional goods from Maryland businesses. Conversely, a negative spillover impact includes the competitive advantage conferred to businesses that receive tax credits. An increase in sales and jobs at these businesses might be at the expense of sales and jobs at other businesses that do not receive the tax benefit.

The REMI Model

The Department of Legislative Services (DLS) estimated the film tax credit's economic impacts by using the REMI PI+ software. The REMI PI+ software is an economic impact tool that uses historical data and forecasts to create a dynamic model of the Maryland economy. The REMI model is a macroeconomic impact model that incorporates and integrates aspects of four major modeling approaches: (1) input-output; (2) general equilibrium; (3) econometric; and (4) economic geography. The REMI model, at its core, has the inter-industry relationships found in input-output models. As a result, the industry structure of a particular region is captured within the model, as well as transactions between industries. Changes that affect industry sectors that are highly interconnected to the rest of the State and regional economy will often have a greater economic impact than those that are not closely linked.

The REMI model generates year-by-year estimates of the total regional effects of a specific policy initiative or combination of initiatives. The model used by DLS is calibrated to the Maryland and District of Columbia region. Each calibrated region has economic and demographic variables as well as variables that test the economic impact of policy changes. Model simulations can estimate comprehensive economic and demographic effects of policies and programs for economic development, infrastructure, environment, energy, natural resources, and state and local tax changes. The primary national, state, and county data source for the REMI model is the Bureau of Economic Analysis State Personal Income and Local Area Personal Income series (which also include employment and total population data). This data is available for the United States and states at the summary level (94 industries), and for counties at the sector level (24 industries).

Model Data and Assumptions

Using the REMI PI+ software, DLS estimated the credit's economic impact under two different scenarios. In the first scenario, DLS estimates the impact of the credit on the Maryland economy using the film production activity and credits that have occurred to date as well as the projected credits and expenditures through calendar 2015. In the second scenario, DLS estimates the economic impact of continuing to provide \$15 million in annual program funding.

In both scenarios, DLS assumed that all of the productions that received the credit would not have filmed in Maryland in the absence of the tax credit. Using this assumption, the film production expenditures represent new spending in the State. The film production credit attracts productions to film in Maryland by offsetting about a quarter of the qualified film and television production costs. The film industry is a very mobile industry that is able to relocate production easily. As previously discussed, there has been a significant exodus of films produced in California to other states that offer significant film production incentives. Other state agencies, such as in Pennsylvania and Connecticut, have made similar assumptions when evaluating their film tax credits. However, a few state studies have attempted to make various assumptions to determine what film production activity results directly from the incentives. Massachusetts excluded all activity that pre-dated their incentives and Alaska did not include television series that have filmed in Alaska for at least two years prior to their credit.

The assumption that 100% of the production activity would not have occurred in the State in the absence of the credit illustrates the maximum economic benefit of the program. Some productions may have filmed in Maryland regardless of the credit or in exchange for a less generous credit. Although film tax incentives now dominate most film production decisions, film productions weigh numerous other considerations such as the availability of studios, the quality and supply of workers, climate, and appropriate scenery. In addition to tax credits, Maryland offers natural beauty, distinct neighborhoods, and a talented workforce to attract film productions to the State.

As this scenario represents the maximum economic activity resulting from the film credit, the actual economic impact may be less. For example, *Ping Pong Summer*, written and directed by Maryland native Michael Tully, received over \$200,000 in film production credits, but it is likely that the movie would have been filmed in the State regardless of the credit. *The Washington Post* quoted Tully, "If it was a decision between never making it or making it somewhere else, I would have decided not to make it." Thus, *Ping Pong Summer* likely did not generate new economic activity to the State as the production was not lured into Maryland from a different state as a result of the credit. Additionally, it is unknown if productions would have filmed in Maryland if they were offered a less generous credit than the existing credit. As discussed previously, *House of Cards* delayed filming of its third season and threatened to leave the State unless the General Assembly enacted legislation increasing program funding to ensure it received the full amount of credits for which it was qualified. Based on its projected spending for the next season, \$60.5 million, it qualified for a \$16.3 million credit but had only received a commitment of \$4.0 million, as the Department of Business and Economic Development (DBED) had allocated

all remaining tax credits. Ultimately, legislation did not provide for the full amount of the difference, and DBED was authorized to use \$7.5 million in grant monies to supplement the tax credit program. Combined with the existing committed tax credits, *House of Cards* received \$11.5 million, or about \$4.8 million less than the full amount of credits it could have received.

It is not clear how much less in tax credits the State could have provided to *House of Cards* or other productions. States with less generous credits, such as New Jersey, have fully allocated tax credits in each year. *House of Cards* has invested over \$500,000 in its studio and has established relations and efficiencies with local vendors; if *House of Cards* did move out of the State, it would not be a costless transaction.

In addition to assuming that 100% of the production activity would not have occurred in the State in the absence of the credit, DLS assumes that “above the line” personnel spend their compensation in Maryland, and thus the production expenditures for above the line personnel are included in the model. The compensation of above the line personnel exceeds \$500,000 and is therefore not eligible for the tax credit. This assumption illustrates the maximum economic benefit of the program, as it is likely that a significant portion of compensation to above the line personnel is spent outside of Maryland. Production expenditures for above the line personnel totaled \$21.5 million for the first two seasons of *VEEP* and *House of Cards*. If production spending for above the line personnel was excluded from the model, the employment, gross domestic product (GDP), and disposable personal income would be approximately 15% lower.

Exhibit 3.1 shows the amount of tax credits awarded by DBED for each qualified production and the total qualified expenses incurred by these productions from calendar 2011 through 2016. Expenditure data for 2014 and 2015 are preliminary estimates based on information provided by DBED.

Exhibit 3.1
Film Production Expenses and Tax Credits
Calendar 2011-2016

<u>Productions</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Total</u>	<u>Final Certificate Issue Date</u>	<u>Credit Amount</u>
<i>VEEP</i> Season 1	\$14,126,384						\$14,126,384	10/17/2012	\$3,410,885
<i>Better Living Through Chemistry</i>		\$2,811,459					2,811,459	3/5/2013	691,189
<i>Jamesy Boy</i>		2,526,121					2,526,121	4/1/2013	600,000
<i>Ping Pong Summer</i>		962,531					962,531	4/22/2013	231,250
<i>House of Cards</i> Season 1		63,680,906					63,680,906	7/12/2013	11,676,029
<i>VEEP</i> Season 2		13,167,729	\$10,079,002				23,246,731	3/14/2014	5,415,019
<i>House of Cards</i> Season 2			54,817,158				54,817,158	8/6/2014	14,397,646
<i>VEEP</i> Season 3			10,709,251	\$13,240,529			23,949,780	1/1/2015	6,465,148
<i>VEEP</i> Season 4				21,094,950	\$6,420,203		27,515,153	1/1/2016	7,429,091
<i>House of Cards</i> Season 3				60,544,904			60,544,904	9/1/2015	11,500,000
Total Expenditures	\$14,126,384	\$83,148,746	\$75,605,411	\$94,880,383	\$6,420,203	\$0	\$274,181,127		
Total Credits	\$0	\$3,410,885	\$13,198,468	\$27,312,665	\$10,465,148	\$7,429,091			\$61,816,257

Source: Department of Business and Economic Development; Department of Legislative Services

Estimated Economic Impacts

Assuming that all productions claiming the credit would not have filmed in the State without the credit, the film production credit increased Maryland employment in 2012 by about 1,400 jobs. Employment increases in subsequent years, then decreases and turns negative as production activity ceases. Under the second scenario, DLS finds that a \$15 million film credit in one year increases employment by approximately 1,000 jobs in the short term. While the credit is a short-term stimulus to the economy, it does not provide much, if any, long-term economic stimulus due to the nature of film production activity. The credit does not provide any sustainable employment; the economic activity is dependent on continued productions in each year and does not provide long-term economic development.

Scenario #1 – Production Activity and Fiscal 2012-2016 Tax Credits

Positive Effects of Tax Credit Spending

Exhibit 3.2 shows the maximum positive economic impacts of the tax credit. Employment increases by approximately 1,400 jobs, relative to the baseline employment estimate in 2012. DBED generally certifies credits in the following year after production activity occurs. Thus in the final year, 2016, there is no production spending, so the economic model attempts to return to baseline. In calendar 2012 through 2016, film productions increased average annual employment by 735 jobs and there is a net State GDP increase of \$316.9 million. Similarly, disposable personal income across the entire State increases by \$36.7 million (0.01% overall increase) in 2012 and by \$2.7 million in 2016.

Exhibit 3.2
Film Production Expenditure Impacts
Employment, Income, and Gross Domestic Product

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Employment (Individuals)					
Baseline	3,443,519	3,471,326	3,530,056	3,607,120	3,688,458
After Credit	3,444,919	3,472,386	3,531,320	3,607,157	3,688,370
Net Effect	1,400	1,060	1,264	37	(88)
Gross Domestic Product (\$ in Millions)					
Baseline	\$326,397	\$330,866	\$340,310	\$352,226	\$364,659
After Credit	326,514	330,957	340,422	352,230	364,652
Net Effect	\$117	\$91	\$113	\$4	(\$7)
Disposable Personal Income (\$ in Millions)					
Baseline	\$272,880	\$271,062	\$277,622	\$286,267	\$296,401
After Credit	272,917	271,093	277,660	286,276	296,404
Net Effect	\$37	\$31	\$38	\$9	\$3

Numbers may not sum to total due to rounding.

Note: REMI defines a “job” as a unit of labor equivalent to 12 months of employment in a given year. REMI determines the number of jobs based on the amount of output for an industry and the labor productivity of the area. Specifically, the number of “jobs” in any given year is an industry’s output, divided by the average labor productivity of the industry. Effectively, what this means is that “jobs” are relative to the average labor productivity of an industry and do not represent specific individuals in that industry.

Source: Department of Legislative Services

Offsetting Foregone Income Tax Revenue

A film production activity tax credit has a positive effect on the local economy in light of other factors: increased production expenditures are passed on to workers in the form of additional jobs; the region’s personal disposable income rises; and GDP increases. However, to accurately reflect the full economic impact – which includes the State’s requirement to maintain a balanced budget – a reduction in tax revenue from a film production credit must be offset by (1) decreasing government spending; (2) increasing revenue from other sources; or (3) a combination of both revenue increases and spending decreases. The film production credit was likely offset by a reduction in government spending, rather than an increase in revenue from other sources.

To balance the State budget, DLS assumed there was a corresponding reduction in government spending equal to the total amount of final credit certificates issued in each year. The effects of this decreased government spending resulting from issuing film production credits are shown in **Exhibit 3.3** below. The State cannot spend the money provided by tax credits on other

State programs because the State must have a balanced budget. For example, in 2012 DBED issued a total of \$3.4 million in credits; this requires a corresponding decrease in government spending to balance the State budget. Government spending is relatively labor intensive; more of each dollar spent by the State is allocated to employee compensation than in most private-sector industries. Reducing government spending reduces both government employment and, through lower overall demand in the economy, some private-sector jobs. On average, the required reduction in government spending as a result of the film production credit decreases employment by 261 jobs, GDP by \$20.3 million, and disposable personal income by \$14.1 million.

Exhibit 3.3
Reduction in Government Spending Impact
Employment, Income, and Gross Domestic Product

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Employment (Individuals)					
Baseline	3,443,519	3,471,326	3,530,056	3,607,120	3,688,458
After Credit	3,443,445	3,471,043	3,529,479	3,606,898	3,688,311
Net Effect	(74)	(283)	(577)	(222)	(147)
Gross Domestic Product (\$ in Millions)					
Baseline	\$326,397	\$330,866	\$340,310	\$352,226	\$364,659
After Credit	326,392	330,844	340,264	352,209	364,648
Net Effect	(\$6)	(\$22)	(\$45)	(\$17)	(\$11)
Disposable Personal Income (\$ in Millions)					
Baseline	\$272,880	\$271,062	\$277,622	\$286,267	\$296,401
After Credit	272,877	271,049	277,593	286,253	296,390
Net Effect	(\$3)	(\$13)	(\$28)	(\$14)	(\$11)

Numbers may not sum to total due to rounding.

Note: REMI defines a “job” as a unit of labor equivalent to 12 months of employment in a given year. REMI determines the number of jobs based on the amount of output for an industry and the labor productivity of the area. Specifically, the number of “jobs” in any given year is an industry’s output, divided by the average labor productivity of the industry. Effectively, what this means is that “jobs” are relative to the average labor productivity of an industry and do not represent specific individuals in that industry.

Source: Department of Legislative Services

Net Effects of the Tax Credit

The net economic impact resulting from the combined impacts of the tax credit are initially positive. In 2012, total net employment increased by 1,325 jobs (a 0.04% increase in employment), net disposable personal income increased by \$33.3 million, and net GDP increased by \$111.0 million. However, the positive benefits are short-lived, with total employment decreasing by 236 jobs (a 0.01% decrease in employment), disposable personal income declining by \$8.3 million, and GDP decreasing by \$18.7 million in 2016 relative to the baseline. Not only are the gains short-lived, but the State is actually worse off in the later years as there are fewer jobs compared to if there was no credit. The State essentially continues to pay for the credit after the production activity has ceased. The results are summarized below in **Exhibit 3.4**.

Exhibit 3.4
Net Film Production Activity Tax Credit Impacts
Employment, Income, and Gross Domestic Product
(\$ in Millions)

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Employment (Individuals)					
Baseline	3,443,519	3,471,326	3,530,056	3,607,120	3,688,458
After Credit	3,444,844	3,472,102	3,530,743	3,606,934	3,688,222
Net Effect	1,325	776	687	(186)	(236)
Gross Domestic Product					
Baseline	\$326,397	\$330,866	\$340,310	\$352,226	\$364,659
After Credit	326,508	330,935	340,377	352,213	364,641
Net Effect	\$111	\$69	\$67	(\$14)	(\$19)
Disposable Personal Income					
Baseline	\$272,880	\$271,062	\$277,622	\$286,267	\$296,401
After Credit	272,914	271,080	277,632	286,262	296,393
Net Effect	\$33	\$18	\$10	(\$5)	(\$8)

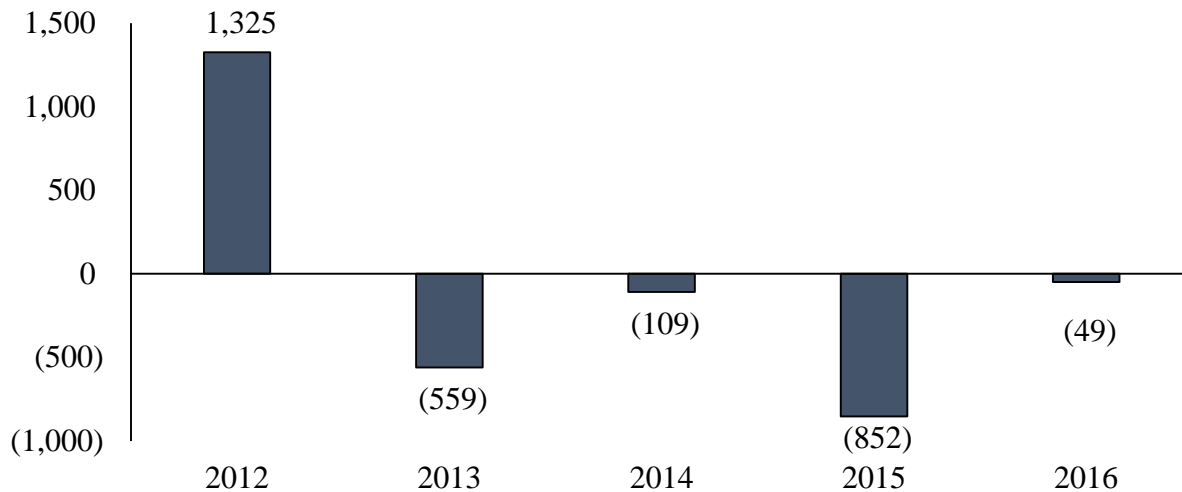
Numbers may not sum to total due to rounding.

Note: REMI defines a “job” as a unit of labor equivalent to 12 months of employment in a given year. REMI determines the number of jobs based on the amount of output for an industry and the labor productivity of the area. Specifically, the number of “jobs” in any given year is an industry’s output, divided by the average labor productivity of the industry. Effectively, what this means is that “jobs” are relative to the average labor productivity of an industry and do not represent specific individuals in that industry.

Source: Department of Legislative Services

The previous exhibits presented the tax credit's estimated impact relative to a baseline forecast. The annual change in employment resulting from the credit is shown in **Exhibit 3.5**. In 2012, total employment increases by 1,325 jobs as productions are spending significant amounts but as a result of the time lag in claiming the credit, the State has not yet incurred significant costs. However, in 2013 when productions begin receiving the credits, employment decreases by almost 600 jobs, with approximately 40% of the jobs that appeared in 2012 disappearing. By 2015, the employment gains of 2012 are completely gone.

Exhibit 3.5
Net Annual Change in Total Employment



Source: Department of Legislative Services

Scenario #2 – Economic Impact of a \$15 Million Film Tax Credit

In this scenario, DLS modeled the economic impact of continuing the film tax credit for one year. Based on historical data of the film tax credit's impact on production expenditures, DLS estimates that a \$15.0 million film tax credit would increase film production by \$66.6 million. A \$66.6 million increase in film production expenditures in 2013, offset by a \$15.0 million decrease in government spending in 2014, would create approximately 1,300 jobs in 2013. However, employment would decrease by 257 jobs compared to the baseline in the following year; there is no additional production output, but as a result of the time lag in claiming credits, the State realizes the cost of the credits in the following year. State GDP increases by \$85.3 million in 2013, but then decreases by \$20.9 million in 2014. Likewise, disposable personal income increases by \$36.7 million in 2013, but then declines by \$9.1 million in the following year. **Exhibit 3.6** shows the economic and employment impacts of providing a one-time \$15.0 million credit.

Exhibit 3.6
Net Impact of \$15 Million in Film Production Activity Tax Credits
Employment, Income, and Gross Domestic Product
(\$ in Millions)

	<u>2013</u>	<u>2014</u>	<u>Net</u>
Employment (Individuals)	1,292	(257)	1,035
Gross Domestic Product	\$85.3	(\$20.9)	\$64.4
Disposable Personal Income	\$36.7	(\$9.1)	\$27.6

Note: REMI defines a “job” as a unit of labor equivalent to 12 months of employment in a given year. REMI determines the number of jobs based on the amount of output for an industry and the labor productivity of the area. Specifically, the number of “jobs” in any given year is an industry’s output, divided by the average labor productivity of the industry. Effectively, what this means is that “jobs” are relative to the average labor productivity of an industry and do not represent specific individuals in that industry.

Source: Department of Legislative Services

As this hypothetical scenario shows, the benefits of the film tax credit are short-lived as the credit generates temporary instead of permanent jobs. The threat by *House of Cards* to break down their stage, sets, and offices and set up in another state highlights the temporary economic impact of this credit. Film projects can be canceled with little or no warning, and local spending and jobs quickly disappear once a production ends.

State and Local Return on Investment

The State has allocated a total of \$62.5 million in film production activity tax credits, of which DBED has committed \$61.8 million. The previous section presented estimates on the net economic gain to the State from providing these credits. Increased employment and output typically generate additional governmental tax and fee revenues. Capturing this effect on the net cost of a tax policy is typically referred to dynamic scoring, as compared to static cost estimates that only include the loss in revenue. The Congressional Budget Office, the U.S. Treasury’s Office of Tax Analysis, and the Joint Committee on Taxation typically incorporate dynamic scoring when analyzing national tax policy changes. These analyses have consistently found that any revenue resulting from increased economic activity offsets, at best, a modest portion of the revenue loss resulting from a tax cut. For example, the consensus view is that federal tax cuts influence national income levels, but not to the extent that they are fully self-financing.

State-level tax impacts can vary from national tax policies. Companies are more mobile across state boundaries, particularly the film industry; tax reductions might result in greater changes in firm behavior and resulting economic impacts. However, the value of the film tax

credit goes far beyond reducing any tax liabilities. In fact, it is not tied to actual tax liability, and pays for about one-quarter of a production's qualified expenditures. When combined with the sales and use tax exemption, foregone revenues can comprise up to one-third of a production's total expenditures.

Using the REMI analysis, DLS produced a dynamic assessment of the net impact of the credit on State finances by offsetting the "static" revenue loss resulting from the allocation of tax credits against the increase in tax revenues resulting from the tax credit's estimated additional economic benefits. DLS examined the major sources of State revenue: individual income tax revenue; corporate income tax revenue; sales tax revenue; and property tax revenue. While other State and local taxes including hotel rental taxes may be affected, the impact is small and does not have a discernable effect on the return on investment (ROI). The taxes examined by DLS comprise about 85% of State general fund revenues and do not include several major sources of revenue that are not directly impacted by economic activity, such as the estate and inheritance tax, or have limited correlation such as tobacco taxes. To calculate the impact on corporate and personal income taxes, DLS incorporated historical trends and recent tax law changes to calculate effective tax rates. For example, DLS assumed a 4.56% effective tax rate for the personal income tax. The estimated increase in sales tax revenue is based on a 6% tax rate and accounts for tax-exempt purchases but did not reflect qualified tax-exempt sales, rentals, and services made by production companies. Accordingly, sales tax revenue increases may be less than estimated. The State property tax is based on the current State property tax rate of \$0.112 and the local property tax rate is based on historical trends.

Between fiscal 2012 and 2016, the film credit generates an estimated \$3.8 million of total additional revenue to the State, but costs the State \$61.8 million. For every \$1 in film tax credits awarded, the State recoups just over 6 cents in tax revenue from the associated economic activity. As seen in **Exhibit 3.7**, it is clear that the film credit does not pay for itself. This is not surprising since tax incentives seldom return more in tax revenues than they cost. Maryland's ROI is similar to estimates of other state film credit programs calculated by independent studies.

Exhibit 3.7
Total Estimated State and Local Return on Investment
Fiscal 2012-1016

<u>State Revenue</u>	
Individual Income Tax	\$2,445,000
Corporate Income Tax	754,000
Sales Tax	527,000
Property Tax	96,000
Total State Revenue	\$3,822,000
Cost of Tax Credits to the State	\$61,816,000
State Return on Investment	6.2%
<u>Local Revenue</u>	
Individual Income Tax	\$1,513,000
Property Tax	946,000
Total Local Revenue	\$2,459,000
State and Local Return on Investment	10.2%

Note: Numbers may not sum to total due to rounding.

Source: Department of Legislative Services

While local governments do not pay for the film tax credit, local governments do benefit from the credit. The film credit generated an estimated \$2.5 million in revenue to local governments from individual income tax and property tax revenues. For every \$1 in film tax credit awarded, local governments receive 4 cents in tax revenue from the associated economic activity. Thus, the film production credit produces an estimated 10 cents in total State and local taxes for each dollar of credit granted to film productions. While the credit may produce economic benefits that accrue to certain businesses and individuals, the credit does not pay for itself.

Decreasing Cost Effectiveness of State Incentives

Since 2001, the State has established several financial incentive programs designed to attract film and television productions. As previously discussed, the value of the subsidies relative to production costs and total funding has increased over time as DBED determined that additional money was required to stay competitive with other state programs. **Exhibit 3.8** compares the total expenditures and credits or grants received by television productions under the wage rebate, production rebate, and tax credit programs.

Exhibit 3.8
Television Series Production Expenditures and Incentives
Fiscal 2006-2016

<u>TV Series</u>	<u>Spend</u>	<u>Credit</u>	<u>%</u>	<u>Fiscal Year</u>	<u>Program</u>
<i>The Wire</i> (Season 4)	\$28,276,200	\$1,600,000	5.7%	2006	Wage Rebate
<i>The Wire</i> (Season 5)	13,082,500	2,000,000	15.3%	2007	Production Rebate
<i>House of Cards</i> 1	63,680,900	11,676,000	18.3%	2012-2014	Tax Credit
<i>House of Cards</i> 2	54,817,200	14,397,600	26.3%	2014	Tax Credit
<i>House of Cards</i> 3	60,544,900	11,500,000	19.0%	2014, 2016	Tax Credit
<i>VEEP</i> 1	14,126,400	3,410,900	24.1%	2012	Tax Credit
<i>VEEP</i> 2	23,246,700	5,415,000	23.3%	2014	Tax Credit
<i>VEEP</i> 3	23,949,800	6,465,100	27.0%	2014-2015	Tax Credit
<i>VEEP</i> 4	27,515,200	7,429,100	27.0%	2015-2016	Tax Credit

Source: Department of Business and Economic Development

As the programs evolved, the State provided additional incentives for every production dollar spent in the State. For example, Season 4 of *The Wire* spent slightly more than the projected amount for Season 4 of *VEEP*; however, the production credit was one-fifth of *VEEP*'s estimated credit. Season 4 of *The Wire* spent \$17.67 in the State for every dollar received under the wage rebate program, compared to a projected \$3.70 for Season 4 of *VEEP*.

The credits shown here do not include the impact of the film production activity sales and use tax exemption, thereby underestimating the total State revenue loss for each production. For example, the tax-exempt purchases made by Season 4 of *The Wire* resulted in an estimated \$152,300 in foregone sales and use tax revenue. The amount of foregone sales and use tax revenue has increased along with production expenditures – in each season of *VEEP*, foregone sales and use tax revenues averaged between \$310,000 and \$480,000, and in fiscal 2014, *House of Cards* had an estimated \$3 million in sales and use tax exemptions.

Exhibit 3.9 compares the amount of production expenses and incentives received under the financial assistance programs since fiscal 2001.

Exhibit 3.9
Film Production Expenditures
and Financial Incentives
Fiscal 2001-2016

<u>Program</u>	<u>Fiscal</u>	<u>Expenditures</u>	<u>Incentives</u>	<u>Credit %</u>	<u>Expenditures/ Credit</u>
Sales Tax Exemption	2001-2005	\$203,645,200	\$4,084,000	2.0%	\$49.86
Employer Wage Rebate	2006-2007	53,161,500	6,300,000	11.9%	8.44
Production Rebate	2008-2011	55,578,400	12,622,000	22.7%	4.40
Film Production Activity Tax Credit	2012-2016	274,181,100	61,816,300	22.5%	4.44

Source: Department of Business and Economic Development

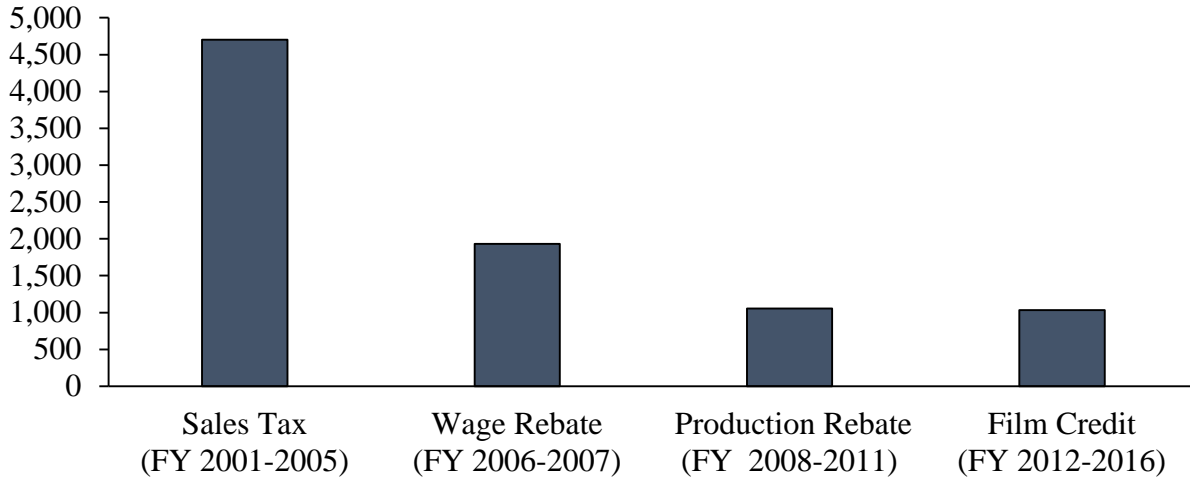
Estimated Economic Impact of Various Incentives

Based on reported film production expenditures for entities claiming the incentives and associated State costs, DLS compared the employment effects of a production that received a subsidy under the existing film production activity tax credit, the film production wage rebate, the employer wage rebate program, and sales and use tax exemption. Under each scenario, it is assumed that the production receives a total of \$15 million under each program, and does not claim any other incentive. It is also assumed that in the absence of each incentive, the production would not have occurred in the State.

Over time, states have increased the total amount of incentives and generosity of the incentives provided to the film industry. In response, the State has increased the value of subsidies relative to production costs in order to provide a sufficient incentive, decreasing the net economic benefit to the State. As **Exhibit 3.10** shows, a \$15 million subsidy under the sales tax exemption that was in effect in fiscal 2001 through 2005 is associated with the most employment, 4,704 jobs, with the film production activity tax credit and Film Production Rebate Program in fiscal 2008 through 2011 only, resulting in about 1,000 jobs. Similarly, the cost per job of the film production activity tax credit, \$14,000, is significantly more than for the earlier programs, as shown in **Exhibit 3.11**.

Additionally, the State ROI from the film incentives has also decreased over time, under the assumptions above. For each dollar the State spent on film production credits and the film production rebate, State and local governments received about 10 cents in revenue. This is significantly less than the employer wage rebate program's ROI, which generated about 30 cents in State and local revenues for a production that filmed in the State. The decreasing rate of return from State film incentives reflects program enhancements driven by increasing competition among states. As the number of states offering film incentives and the amounts offered have dramatically increased in recent years, states must commit significantly more dollars in order to attract productions. As a result, over time, states receive less economic benefits from film productions.

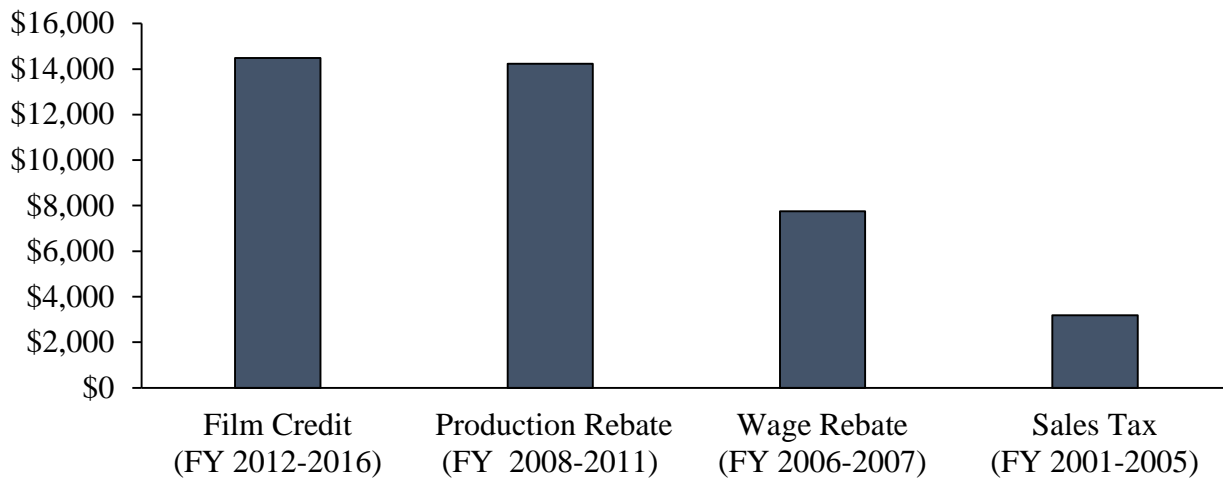
Exhibit 3.10
Employment Impacts of \$15 Million State Film Incentive under Different Incentives



Note: REMI defines a “job” as a unit of labor equivalent to 12 months of employment in a given year. REMI determines the number of jobs based on the amount of output for an industry and the labor productivity of the area. Specifically, the number of “jobs” in any given year is an industry’s output, divided by the average labor productivity of the industry. Effectively, what this means is that “jobs” are relative to the average labor productivity of an industry and do not represent specific individuals in that industry.

Source: Department of Legislative Services

Exhibit 3.11
Cost Per Job under State Film Incentives



Source: Department of Legislative Services

It should be noted that Exhibits 3.10 and 3.11 show the economic impacts for each incentive, assuming that the film production activity that occurs in the State is only due to the receipt of a \$15 million incentive under each program. It illustrates how, over time, the State has increased the generosity of incentives in response to competition from other states, thereby decreasing the cost effectiveness of film incentives. Accordingly, it is not an estimate of each program's total economic impact, which may be significantly less than estimated. For example, the sales and use tax exemption applies to a broader range of activities than the other incentives, including the production of commercials and other productions undertaken by local businesses which would have likely incurred the expenditures in the absence of the exemption. In addition, the estimates do not represent the present impact of the program. For example, the sales and use tax exemption was the only incentive offered before fiscal 2006. It is no longer a sufficient incentive to attract significant television and film production activities – these entities claim the exemption along with the more substantial film production activity tax credit.

Chapter 4. Impacts of Maryland's Film Industry

The Film Industry is a Minor Employer in Maryland

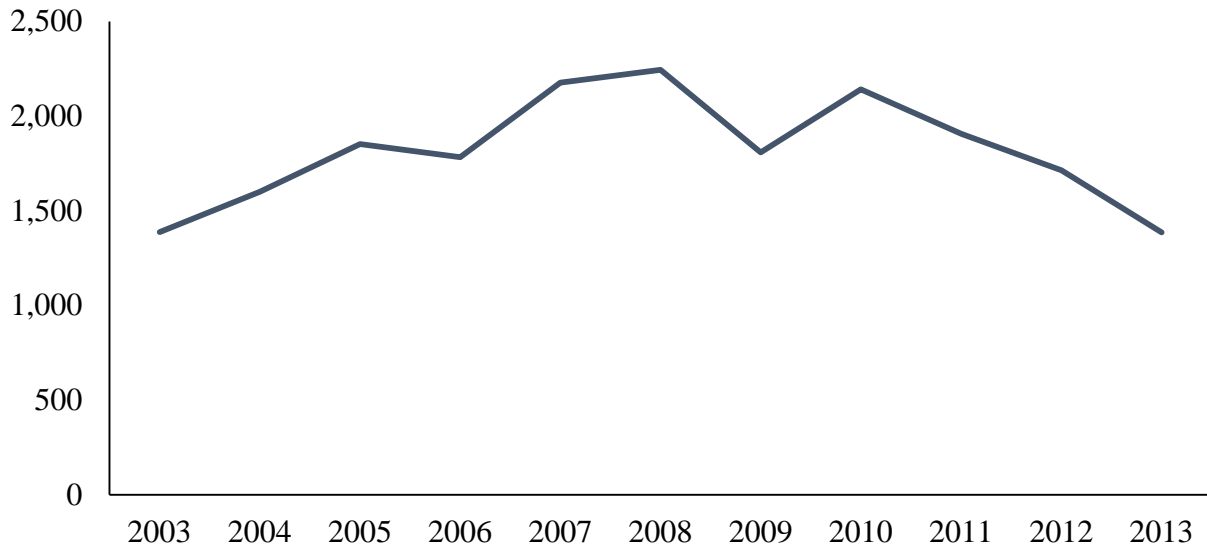
The Maryland film industry is a minor employer, comprising between 0.05% and 0.08% of all Maryland private employment since the 1990s. Compared to the rest of the nation, the film industry is less important to Maryland's economy. Since the 2000s, Maryland film industry employment has been relatively unchanged, averaging between 1,400 and 1,500. This includes employment of film and video production workers (NAICS Code 51211) and postproduction and other film and video production workers (NAICS Code 51219). Maryland employment within the media industry, including television, is significantly higher. For example, Discovery Communications, within the Media Broadcasting industry (NAICS Code 515), reportedly employed 1,900 workers in 2010 at its Silver Spring headquarters. The U.S. Bureau of Labor Statistics (BLS) projects that employment in several job occupations within the industry are projected to grow at a slower rate than the national average, and opportunities will center in entertainment areas such as New York City.

BLS calculates industry location quotients comparing the relative importance and concentration of an industry within a state to the national average or other states. The ratios are calculated by comparing the industry's share of regional employment with its share of national employment. The Maryland location quotient for film and video production workers is 0.33, so the film industry's share of Maryland employment is one-third that of the national average. In comparison, Maryland's location quotient for scientific and research and development is 2.72. The Maryland film industry comprises about 0.8% of total U.S. employment in the industry in 2012, significantly less than Maryland's 1.8% share of total U.S. private employment. Other Maryland industries have a significantly higher share of total U.S. employment – for example, the Department of Business and Economic Development calculates that Maryland bioscience employment comprises 8.0% of the total U.S. industry employment.

Maryland Film Industry Employment Over the Last Decade

Employment in the film industry has varied over the past 10 years in Maryland. Employment of film and video production workers and postproduction and other film and video production workers peaked in 2008 with over 2,200 employees in these industries, but then fell to 1,385 workers in 2013. **Exhibit 4.1** shows the employment of these workers in Maryland from 2003 through 2013. Employment in the film industry over this time makes up less than 0.1% of total employment in the State.

Exhibit 4.1
Maryland Employment of Film/Video Production
and Postproduction Workers
Calendar 2003-2013



Source: U.S. Bureau of Labor Statistics; Department of Legislative Services

As **Exhibit 4.2** shows, Maryland employment within the film industry makes up only a small share of overall U.S. employment within the film industry. In the past 10 years, the State's share of film industry workers has averaged 0.9% of the national employment within the film industry. From 2004 through 2013, the national employment within the film industry grew by 7.4% while Maryland employment within the film industry decreased by 13.4%.

Exhibit 4.2
Film Industry Employment in the United States and Maryland
Calendar 2004-2013

<u>Year</u>	<u>U.S.</u>	<u>% Growth</u>	<u>MD</u>	<u>% Growth</u>	<u>MD Share of U.S.</u>
2004	212,938		1,600		0.8%
2005	209,470	-1.6%	1,853	15.8%	0.9%
2006	210,132	0.3%	1,783	-3.8%	0.8%
2007	213,876	1.8%	2,177	22.1%	1.0%
2008	223,538	4.5%	2,245	3.1%	1.0%
2009	203,493	-9.0%	1,809	-19.4%	0.9%
2010	216,430	6.4%	2,141	18.4%	1.0%
2011	218,012	0.7%	1,907	-10.9%	0.9%
2012	223,604	2.6%	1,713	-10.2%	0.8%
2013	228,692	2.3%	1,385	-19.1%	0.6%

Source: U.S. Bureau of Labor Statistics; Department of Legislative Services

The change in employment of the film and video production and postproduction workers from 2005 through 2013 did not follow statewide employment trends during that time. Statewide employment remained relatively stable from year to year while employment in the film industry in Maryland fluctuated greatly during that time. Nationally, employment in the film industry has been relatively stable, except from 2008 through 2010.

Film Tourism in Maryland

Film tourism occurs when people visit locations that appear in productions. Proponents of film credits argue that film locations become popular tourist attractions, often providing anecdotal evidence of films increasing tourism in a particular location. However, there is limited academic research on the direct impacts of film tourism, and few tourist organizations attempt to measure its impact. Maryland's Office of Tourism does not account for film tourism in its annual report. The Department of Legislative Services has not seen evidence of notable film-induced tourism in the State that can be attributed to the film production activity tax credit.

Researchers recognize that film-induced tourism is complex and dynamic. Given the various psychological and behavioral aspects behind film tourism, studies acknowledge the need for further research. Given the challenges of determining the motivational factors behind tourism, the Federal Reserve Bank of Boston reports that "attributing tourism spending to a film credit is difficult, if not impossible." Every dollar spent at a film tourist site cannot be attributed to the tax credit. One needs to consider whether the people visiting the tourist destination are State residents who would have otherwise spent their income elsewhere in the State. People usually have a limited amount of money to spend on entertainment so if they spend money on film tourism, they are

likely not spending money on other forms of entertainment. If the film tourists are residents from other states, one must determine whether the film site attracted them to the State or whether they would have visited anyway. Additionally, one must consider how the film tourist site affected overall spending in the State. Local restaurants and hotels made popular as a result of a film may take business from other local restaurants and hotels. As a result, film tourism might not represent net new economic activity.

Despite the lack of strong empirical evidence regarding the impacts of film tourism, there is consensus that films have the potential to promote tourism, especially after a film is initially released. Films can raise awareness, form images, develop expectations, and aid in making decisions on visiting a location. Proponents have noted that some actors have publicly praised some locations in Maryland. Thus, film and television productions can have a positive impact on tourism for a local economy. Given this, some states, such as Montana, Wisconsin, and South Dakota, have their tourism commission partner with the film commission to promote their state. In Maryland, Worcester County and Ocean City granted funds to *Ping Pong Summer* from their respective tourism budgets.

While films can have a positive effect on tourism, not every production can be assumed to create an economic impact from tourism. The productions that received film credits in Maryland do not appear to have contributed much to film tourism in the State. While both *VEEP* and *House of Cards* are filmed in Maryland, they depict locations in Washington, DC, so many viewers are unaware of the productions' actual locations. According to an Ernst and Young report, "a film that is a commercial success but portrays locations in a state as being in another jurisdiction will not generate positive tourism impacts." A vast majority of the film production activity tax credits have been claimed by these productions. These productions do not showcase the State's many tourist attractions, including Annapolis, Western Maryland, Baltimore City, and Ocean City.

Additionally, Ernst and Young notes that, "a film that prominently features a state's tourism assets but is not widely viewed will have a limited tourism impact." *Ping Pong Summer* showcases Ocean City but was not widely seen during its initial release, having only been released in 17 theaters and grossing \$26,000 on its opening weekend at the box office. Thus, it is unlikely the movie has widely impacted Ocean City tourism.

Chapter 5. Impacts of Film Incentives on the U.S. Economy and in Selected States

Benefits to the U.S. Economy are Less Than Estimated

On a national level, much of the estimated increase in revenue and economic activity from film production represents a reallocation of, rather than net new, film activity. Any economic and revenue gains resulting from attracting a production is accompanied by a corresponding loss in another state. While states individually assess the impact of each film production activity tax credit, the combined economic impact of the subsidies on the U.S. economy is much less, and results in lower U.S. economic growth compared to other economic development policies. In contrast to state film tax credits, federal policies strive to increase national output, rather than reallocate it within the United States. For example, the federal Department of Transportation provides grants to help defray part of the cost of port improvements. The department is mindful of the intense competition between U.S. ports, and funds projects that increase the nation's total port infrastructure and capacity, rather than reallocate cargo traffic between ports.

The California Legislative Analyst's Office recently analyzed that state's film tax credit and included an assessment of changes in the U.S. film industry over time. While the report cautioned against drawing strong conclusions from the data, it noted that several trends indicate that growth in the motion picture industry may have slowed over the last decade. The output of the U.S. motion picture industry has not kept pace with the increase in U.S. gross domestic product, growing by a total of about 25% since 1997 compared with a 40% increase in the U.S. economy. Annual movie ticket sales peaked in 2002 and decreased by 16% in 2013. Finally, the annual number of films submitted to the Motion Picture Association of America (MPAA) for rating peaked at 949 in 2003 and has since decreased to an annual average of 700 to 800 in the past five years. The Department of Legislative Services (DLS) notes that these trends are in contrast to the exponential growth in state subsidies from a couple of million dollars in the early 2000s to about \$1.4 billion in calendar 2011.

Economic and Fiscal Impact of Other State Tax Incentives

In the previous section, DLS estimated that the film production activity tax credit's economic benefits are temporary – any prolonged impact necessitates continued production spending and requisite tax credit commitments. In essence, continued funding of this activity creates an industry whose business model is dependent on ongoing State subsidies. From fiscal 2006 to 2011, the Department of Business and Economic Development (DBED) provided production and wage rebate grants to 19 productions, 18 of which do not currently provide any economic benefit to the State as they have ceased production. The exception is the *VEEP* pilot, which spent a modest \$3.1 million in fiscal 2011 and has continued to receive incentives in each year of the film production activity tax credit. In June 2015, HBO announced that production of *VEEP* will relocate to California. This is in contrast to most economic development projects such

as infrastructure projects and other tax credit programs, which aim to provide ongoing economic benefits. For example, DBED awarded a total of \$197.4 million in One Maryland tax credits to 54 qualifying projects from fiscal 2001 through 2012. Of these projects, 90% are still in business, along with 90%, or 2,900, of the total direct jobs certified under the program.

Advocates argue that states can emulate the success of New York and California and develop a strong industry base by providing substantial funds over time. For example, an MPAA-commissioned study asserted that over the long-term, growth in the film industry is expected to increase in-state employment and create multiplier effects that will increase the size of the positive tax revenues relative to the cost of credits. According to this analysis, a state that spends a sustained amount of incentives over time will develop a sufficient industry base. This will lead to synergies which can increase the state's return on investment, and eventually a self-sufficient and sustained industry.

Based on independent studies examining tax credit programs in Michigan and Louisiana, DLS determines that:

- the economic benefits of film production activity tax credits cannot currently be sustained in the absence of continued annual funding of industry subsidies; and
- Louisiana has provided over \$1.3 billion in tax incentives since 2003; however, the program has not increased its return on investment to the state or developed an industry that can be sustained in the absence of significant continued state subsidies.

Michigan Film Incentives

In 2008, under Governor Jennifer M. Granholm, Michigan began offering nationally competitive film incentives with the hopes of developing a film production industry. Michigan enacted these policies in the midst of the recent recession and the job losses and economic distress caused by financial troubles for several automobile manufacturers located in the state. Offering numerous incentives, including an uncapped 40% subsidy for qualified personnel expenditures and an additional 2% subsidy for projects produced in communities targeted for redevelopment, Michigan soon faced increasing expenditures as its film industry ballooned. In 2011, Governor Rick Snyder announced plans to cap the Michigan film incentives, then among the most generous incentives in the nation, and the state legislature passed significant reforms to the program. Following the curtailment of the incentive program, film productions turned elsewhere to greener pastures.

Michigan Incentives: 2008-2010

In April 2008, Michigan enacted a number of film production incentives (Public Acts 74 – 87 of 2008) to encourage in-state film production, both by increasing the local film industry as well as encouraging the importation of film activities from other jurisdictions. In addition to low-interest loans and authorization to use state and local property and facilities free of charge,

these incentives included a wide variety of tax credits. The media production credit offset a percentage of a film's actual production costs through a refundable credit equaling 40% of direct expenditures except for specified personnel expenditures, increasing to 42% for a state-certified qualified production in a redevelopment community, and 30% of qualified personnel expenditures, excluding expenditures for which the taxpayer claimed a Michigan business tax (MBT) credit for job training expenditures. Similarly, the individual income tax media credit allowed an eligible production company to claim an income tax credit against withholding payments made by the production company on wages subject to withholding. Unlike the media production credit, the individual income tax media credit was not refundable, transferable, or subject to carry forward. The media infrastructure credit allowed a MBT credit equal to 25% of a taxpayer's base investment if the taxpayer invested at least \$100,000 before January 1, 2009, or at least \$250,000 after December 31, 2008, in a qualified film and digital media infrastructure project; these credits were limited to a total of \$20 million per year. The media job training credit allowed an eligible production company to enter into an agreement with the Michigan Film Office, with the Michigan State Treasurer's concurrence, in order to receive an MBT credit equal to 50% of qualified job training expenditures. Both the media infrastructure and media job training credits were not refundable, but excess credit amounts could be carried forward for 10 years. Lastly, the Michigan economic growth authority (MEGA) film credit permitted film and digital media production companies to qualify as eligible businesses for purposes of receiving refundable MBT credits under the MEGA Act.

According to annual reports issued by the Michigan Film Office, film expenditures in the state grew dramatically following the implementation of the incentives program. While only \$2 million in film expenditures occurred in the state in 2007, expenditures were approximately \$100 million in 2009. Expenditures continued to increase significantly in 2010 and 2011, accompanied by increasing incentive costs, as shown in **Exhibit 5.1**.

Exhibit 5.1
Michigan Film Production and Tax Credits
Fiscal 2009-2011
(\$ in Millions)

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Film/Media Production Expenses	\$93.8	\$250.0	\$312.5
Tax Credits			
Media Production Credit	(\$37.5)	(\$100.0)	(\$125.0)
Media Infrastructure Credit	0.0	(6.0)	(6.0)
Media MEGA Credit	0.0	(1.6)	(1.6)
Media Job Training Credit	0.0	(2.4)	(2.4)
Total	(\$37.5)	(\$110.0)	(\$135.0)
State Revenue Impact*	(\$30.8)	(\$91.4)	(\$111.8)

*Amounts shown reflect total state revenue losses net of any additional revenues generated from additional economic activity.

Source: Michigan Senate Fiscal Agency: *Film Incentives in Michigan* by David Zin (September 2010)

The Michigan Senate Fiscal Agency observed that the uncapped, refundable media production credit constituted the most costly film incentive. In addition, noting the rapid escalation in the costs of credits in other states with incentives less generous than those offered in Michigan, the agency cautioned that revenue losses attributable to the incentives had a potential to increase substantially in the following years. Furthermore, the agency stated that although Michigan's film production activities generated revenue to partially offset the cost of the credits, those offsets failed to result in a net increase in revenue to the state. Moreover, looking at the Michigan economy as a whole and observing that the film production sector accounted for less than 0.1% of the state's gross domestic product and approximately 0.14% of wage and salary employment, the agency concluded that any potential impact from the incentives was likely to have a negligible impact on the state's economic activity.

Michigan Incentives: 2011-Present

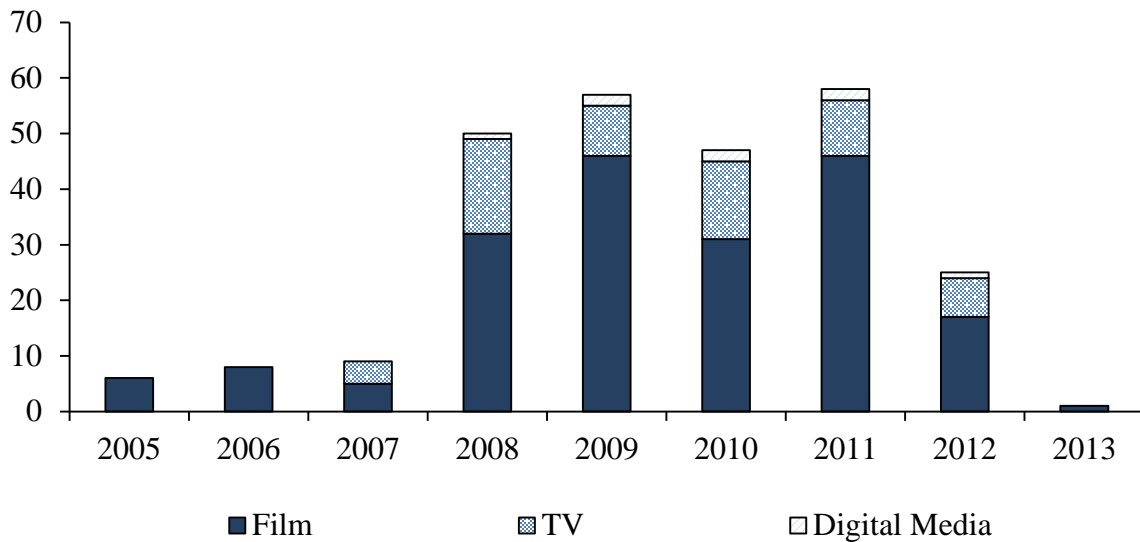
In 2011, as a part of a larger effort to reform the state's income tax and tax credit programs, Michigan significantly restructured and limited its film incentives program. Public Act 38 of 2011, in part, established a new corporate income tax and eliminated many tax credits and tax preferences. However, the Act preserved both the media production credit and media infrastructure credit. Public Act 77 of 2011 also amended the state's film incentives. Most significantly, the Act provided that agreements for certain film industry credits may provide credits up to a certain percentage of expenditures or investments, rather than for a specific percentage of those expenditures and investments (*e.g.*, a credit for up to 40%, rather than a credit for 40%, of direct production expenditures for a production in a part of the state outside of a core community). Effective December 21, 2011, Public Act 291 of 2011 also substantially altered Michigan's film incentive program by requiring the Michigan Film Office to establish and operate the Film and Digital Media Production Assistance Program, authorized to provide assistance for state-certified qualified productions through September 30, 2017. The new incentive program provided qualified production companies up to a 32% incentive for qualifying Michigan expenditures with the opportunity to earn an additional 3% for filming at a qualified production or postproduction facility.

Under Public Act 63 of 2011, a one-time fiscal 2012 appropriation of \$25.0 million was provided for film incentives; this marked a substantial reduction in funding compared to prior years. Although no new tax credits were issued in 2012, the Michigan Film Office issued 37 postproduction certificates of completion for films produced between 2008 and 2011, totaling approximately \$93.0 million of which \$39.4 million was claimed in 2012. In fiscal 2013 and 2014, Michigan increased its film incentive program to \$50.0 million in one-time appropriations. During fiscal 2013, 35 projects (feature films, television series, television pilots, web series, animated web series, and video games) were approved to receive film and digital media production incentives; more than 80% of these projects were independent projects, including many from state-based filmmakers. The film office issued six postproduction certificates of completion in fiscal 2013, totaling approximately \$0.6 million in value. As of December 31, 2013, approximately \$94.1 million in potential film tax credits remain eligible to be claimed under the tax credit program. Although the Governor proposed reducing Michigan's film incentives to \$25.0 million for fiscal 2015, Public Act 252 of 2014 provides an ongoing \$25.0 million appropriation and a

one-time \$25.0 million appropriation for fiscal 2015. Although more generous than the \$25.0 million appropriation for fiscal 2012, these recent film incentive expenditures remain considerably less than those during the height of Michigan’s program. In the wake of smaller appropriations and new caps on the incentives individual film productions are eligible to claim in Michigan, film production activities in the state have decreased in recent years.

In addition to the tax credit program, Michigan issued \$18 million in municipal bonds, guaranteed by the state workers’ pension fund, to back the transformation of the vacated General Motors complex in Pontiac, Michigan into a state-of-the-art film studio. Despite Michigan’s significant fiscal commitment of over \$250 million in tax incentives, employment gains were not permanent as film and television industries moved to other states once incentives declined. With the decline in production, activity at the Pontiac studio waned; the studio’s investors missed scheduled debt service payments and defaulted on an entire \$630,000 debt service payment on the bond in August 2013. At the same time, the investors turned to the state to increase Michigan’s film production credits. **Exhibit 5.2** shows the increase in digital media productions, films, and television series produced in Michigan after the enactment of its film tax incentive programs and the corresponding decrease once Michigan curtailed funding.

Exhibit 5.2
Michigan Films, Television Series, and Digital Media Productions
Calendar 2005-2013



Source: Michigan Film Office

Louisiana Film Incentives

Louisiana emphasizes tax credit programs, including film incentives, in its efforts to promote economic development. According to a recent legislative audit, the state provided a total of \$3 billion in tax credits between 2005 and 2010, equivalent to more than one-half of all corporate income tax revenues over that period. The legislative audit also questioned the lack of accountability in the incentive programs and found that many programs provided most of the benefits to a few firms, including the film incentive program.

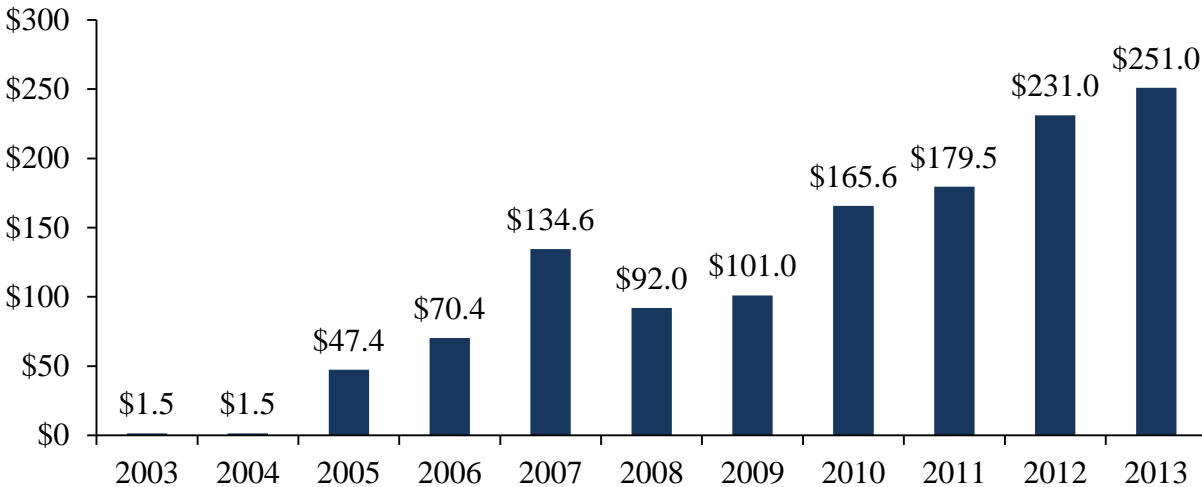
Louisiana was one of the first states to offer film incentives and has consistently been one of the most aggressive – state tax credits totaled \$236.4 million in fiscal 2013, second only to New York. In contrast to New York and California, the state’s goal has been to grow an industry that did not previously exist. The legislation establishing Louisiana’s Motion Picture Tax Credit Program specifies that the purpose is to encourage the development of a strong capital and infrastructure base for motion picture production to achieve an independent, self-supporting industry.

Although the state began offering incentives in 1992, the current program dates to 2002 when the state established both a nontransferable tax credit and a sales tax exemption. Legislation enacted in the following year allowed entities to transfer credits. In 2005, the state enacted major changes to the program, including (1) the addition of an infrastructure tax credit (since terminated) totaling 40%; (2) repealing of the sales tax exemption; (3) setting the percentage rate of the film tax credit to 25% in 2006 through 2009, 20% in 2010 and 2011, and 15% beginning in 2012; and (4) establishing a state buy-back provision that allowed productions to transfer credits back to the state for a discount (currently 85%). In 2009, the state enacted more changes, reversing the decrease in the value of the credit and establishing a credit of 30% for qualified in-state production expenses and an additional 5% for state resident wage labor, subject to certain limitations. The Louisiana Department of Economic Development analyzed seven programs that were available in 2010 through 2012 including incentives for digital media, sound recording, and musical and theatrical production.

Since the state adopted its incentives program, film production has grown steadily, centering in New Orleans, Baton Rouge, and Shreveport. Total certified production expenditures increased from \$467.6 million in 2010 to \$717.2 million in 2012. Advocates estimate that the industry supports thousands of jobs and that the state has developed a deep crew base. A commonly cited example is the success of a company that provides over 400 trucks for the film industry. In 2013, more major studio films were produced in Louisiana than in California, and the state has taken to branding itself “Hollywood South.”

The increased film production activity and economic benefits have been accompanied by ever increasing state fiscal costs. Since 2003, Louisiana has awarded about \$1.3 billion in film production, investor, and infrastructure tax credits, as shown in **Exhibit 5.3**. Over this time period, Louisiana provided significantly more film tax incentives than California, even though its budget is about 12% of California’s.

Exhibit 5.3
Louisiana Film Investment, Employment, and Infrastructure Credits
Calendar 2003-2013
(\$ in Millions)



Source: Louisiana Department of Revenue; Louisiana Economic Development

A number of Louisiana agencies have evaluated the state's film incentive programs, including the Legislative Fiscal Office, the Louisiana Economic Development agency, and the Legislative Audit Office. These agencies have concluded that the state recoups only a portion of the tax credits provided to the industry. The state legislature's chief economist concluded that although the incentives produce economic benefits, the state does not receive more tax receipts back, either directly or indirectly. A 2005 report produced by the Legislative Fiscal Office concluded that even without incorporating the impact of the state's balanced budget requirement, state tax revenue receipts from stimulated economic activity do not exceed state tax credit costs. This result occurred because the estimated multiplier effects from increased economic development were quite small, and could not offset direct tax reductions. The study estimated that Louisiana recouped between 16% and 18% of the tax credits awarded over the long term.

Subsequent studies have also confirmed these findings, although comparing the estimates are difficult due to differences in methodology and changes in the program. In 2011 and 2013, Louisiana Economic Development contracted with a private company to estimate the economic and fiscal impacts of the incentives. These studies estimated that the state recouped between 14% and 26% of the total cost of film tax credits. Both reports estimated that the amount of revenue recouped decreased over the respective three-year study period.

2013 Legislative Proposals

As part of a larger proposal to overhaul Louisiana's tax structure, Governor Bobby Jindal proposed a \$1 million cap on the amount of an individual actor's salary that production companies

could claim. The secretary of the Louisiana Economic Development agency stated that the changes were intended to increase the cost effectiveness of the program and focus less on activities that do not impact the state's economy. The secretary also advised the state had been in contact with major studios, and that they continued to plan major film projects in the state.

The Louisiana film industry disputed this, stating that if the state instituted a cap, it would likely result in the bankruptcy of all the major film studios in the state and lead to the loss of more than 10,000 jobs. In addition, press reports, citing "industry insiders," indicated that projects considering Louisiana were looking elsewhere until the issue was resolved, out of fear that the incentives would be rendered uncompetitive. One production executive stated that the cap would eviscerate the industry, and render the state no longer competitive with other states, particularly Georgia, which has no salary cap or spending cap. Ultimately, Louisiana did not enact the proposed cap on compensation and legislation proposing to reduce the value of the tax credit was withdrawn.

Challenges Facing Louisiana

Louisiana has committed significant state resources in the last decade, including a total of \$481 million in tax credits within the last two years, in its effort to achieve an independent, self-supporting film industry. The industry has grown in response to these efforts, but there is no evidence that this growth has translated into a more cost-effective program reducing the net fiscal impact, necessitating ever increasing annual fiscal commitments.

Louisiana gained an advantage by providing incentives earlier than other states and offering significant incentives. These credits have helped develop a large crew base, supporting businesses, and infrastructure. Louisiana's industry has grown, but there is no evidence that it has become more efficient than other states in the absence of state incentives. The extreme competition among states and counties has distorted market decisions – film productions occur not where it is most efficient to do so, but where the benefit to the firms is greatest after factoring in subsidies. Given the mobility of the film industry and continued extreme competition among states and countries for film productions, the gains to Louisiana may not be sustained without ongoing subsidies.

The large amount of subsidies have likely fostered inefficiencies in the market as production companies have less incentive to reduce costs as governments pay for a significant portion of the total costs. For example, one producer recently commented that if the film was produced in Los Angeles rather than Louisiana, it would have to be filmed much more quickly. A recent analysis concluded that the credit was not cost effective, as the cost to the state was not proportionate to the economic benefits. The analysis recommended capping the program, reducing the value of the credit, and conducting a competitive auction to maximize the state's investment. Louisiana has yet to enact legislation that significantly reduces industry subsidies. Until such time, it is not clear the industry will be able to maintain its current output and become self-sufficient in the absence of incentives.

Chapter 6. Findings and Recommendations

Based on the information and analysis provided in this report, the Department of Legislative Services (DLS) makes a number of findings and recommendations regarding the film production activity tax credit, as discussed below.

The Film Production Activity Tax Credit Does Not Provide Sustainable Economic Development

As discussed in this report, the economic development activity generated by film productions is of a short duration. As soon as a film production ends, all positive economic impacts cease too. As such, the film production activity tax credit does not provide long-term employment. Maryland has allocated \$62.5 million in tax credits between fiscal 2012 and 2016, while only receiving a fraction of the tax credit amounts back in revenues to the State and local governments. Additionally, states are fiercely competing with one another to draw productions into their state. This type of competition is not only expensive, but promotes unhealthy competition among states. It is also very difficult, if not impossible, to determine how much funding the State would have to provide each year in order to develop a sustainable film industry that is also cost effective to the State and local governments.

Recommendation: Since the credit does not provide sustainable economic development and provides a small return on investment to the State and local governments, **DLS recommends that the General Assembly allow the film production activity tax credit to sunset as scheduled on July 1, 2016. Going forward, DLS recommends that the General Assembly focus economic development efforts on incentives that create permanent and lasting employment, rather than temporary jobs.**

However, if the General Assembly decides to extend the film production activity tax credit beyond July 1, 2016, DLS has several recommendations to improve the credit that are discussed below.

The Film Production Activity Tax Credit Is Not Linked to a Production's Taxable Income or Tax Liability

Generally speaking, most tax credits are tied to the income generated by and tax liability of the individual or business claiming the credit. The tax credit is claimed by the taxpayer and may or may not eliminate tax liability; if it does not, any remaining credit can usually be carried forward to additional tax years or may be refundable.

In the case of the film production activity tax credit, the film production entity (or the members of the entity) must file an income tax return in order to claim the credit. After the

Department of Business and Economic Development (DBED) issues a final credit certificate to the entity, the entity must then amend its tax return to claim the credit. Since the credit is refundable, however, whether or not the film production entity generates taxable income or has any tax liability does not matter. Additionally, as with many business tax credits, DBED certifies credits and the Comptroller's Office processes credit claims on tax returns. Since tax returns are confidential, the Comptroller's Office cannot share specific information with DBED about the returns filed or the timing of tax credit claims.

Recommendation: Since the film production activity tax credit does not have a direct connection to a film production entity's taxable income or tax liability, **DLS recommends that the General Assembly consider replacing the tax credit with a grant program funded through the State budget and administered by DBED.** While providing funding through a grant program could cause some uncertainty about funding levels from year to year, there is no compelling reason why film production incentives should be accessed through the tax system. Replacing the tax credit with a grant program could also aid in credit transparency and reduce administrative burdens.

Film Production Activity Has Benefited Some Local Jurisdictions More Than Others

Businesses in Baltimore City and Baltimore, Harford, and Anne Arundel counties have primarily benefited from film productions that receive the film production activity tax credit. Of the over 7,000 vendors used to date, 80% have been located in these four jurisdictions. Meanwhile, Garrett, St. Mary's, and Somerset counties do not have any reported vendors benefiting from film productions in their jurisdictions. Additionally, productions that predominantly highlight a jurisdiction may increase film tourism in the area, benefiting the jurisdiction.

Recommendation: Based on DLS' analysis, for every dollar granted in film tax credits, the State receives 6 cents and local governments receive about 4 cents in return. Since local governments receive approximately 40% of the film credit's return on investment, **DLS recommends that the General Assembly require local governments to contribute a portion of the State's tax credit costs for productions in which at least 50% of the principal photography occurs in that jurisdiction. Alternatively, local governments could contribute a portion of the tax credit's costs based on the proportion of production expenditures in their jurisdictions.**

DBED Should Provide Additional Information about the Film Production Activity Tax Credit and Similar Incentives in Other States

Current law requires DBED to annually provide information to the Governor and General Assembly on the number of film production entities submitting tax credit applications; the number and amount of tax credit certificates issued; and information about local actors, technicians, and

vendors used for film production activity. However, DBED does not provide any information on the size of the vendors or businesses used or how many are small, minority-, and/or women-owned firms. In addition, DBED is not required to report any information on film production incentives provided in other states.

Recommendation: Considering the General Assembly's interest in providing business opportunities for small, minority-, and women-owned businesses, **DLS recommends that the General Assembly require DBED to monitor and report in its annual report on the number of film production vendors that qualify as small, minority-, and women-owned firms. In addition, if the data collected suggests that these firms consist of only a small percentage of the vendors, DBED should consider methods by which film production entities can provide opportunities for small, minority-, and women-owned businesses.**

Recommendation: Considering the nature of the tax credit and the number of states that have continued to increase the types and amounts of incentives awarded, **DLS recommends that the General Assembly require DBED to report annually information on the film production incentives provided in other states, particularly for states with large tax credit programs such as California, New York, Louisiana, and Pennsylvania.**

The Vast Majority of Film Production Activity Tax Credits Have Been Awarded to Two Productions

The Film Production Rebate Program was converted to a tax credit beginning in fiscal 2012. Since that time, approximately \$62.5 million in tax credits have been authorized by the General Assembly. Of that amount, \$60.3 million, or 96.5% of the total, has been awarded to two productions – *House of Cards* and *VEEP*. During that time period, only three other productions have been awarded tax credits, for a total of \$1.5 million. While larger productions of feature films or television series may certainly provide significant spending in the State, it is not clear if portions of the credits provided to these two productions could have instead been allocated to a larger number of productions, potentially providing economic benefits to additional jurisdictions in the State. In addition, information is not readily available as to how DBED and the Maryland film industry work to attract film or television productions to the State and how determinations are made to allocate tax credits to those productions.

Recommendation: **DBED should comment on the process and criteria used to attract film and television productions to Maryland and how allocations of tax credits to these productions are determined. The General Assembly may also wish to consider developing specific criteria to be used by DBED in determining whether productions should be allocated tax credits, including whether limitations on the amount of tax credits that any single production may receive in a given fiscal year would be appropriate.**

Film Production Companies Pit States against One Another for Incentives

As discussed in this report, film production entities “shop around” for the most lucrative state film incentives. While this is often the case with businesses in general, particularly businesses with multi-state operations, most businesses do not come to a state to conduct business, qualify for tax incentives, and then quickly threaten to leave. Businesses usually qualify for tax incentives, set up a physical location in which to do business, and stay if they become profitable. However, even if a motion picture or television series comes to a state to film, there is no guarantee that the production will stay to film sequels or additional seasons. Not only will they not be guaranteed to stay, but they may threaten to leave the state if additional incentives are not provided (*i.e.*, *House of Cards* in 2014). States then increase incentives in an attempt to keep productions, or to lure them from other states, which may not be in the best economic interests of the taxpayers in those states.

Recommendation: DBED should comment on, as a condition of receiving tax credits, the feasibility of requiring a film or television production to commit to staying in the State for the duration of the production of the film or series, essentially requiring a multi-year commitment to the State when appropriate.

Recommendation: The General Assembly may wish to consider legislation that would require the recapture of tax credits awarded to or claimed by a production entity that later leaves the State to film in another jurisdiction, similar to language contained in the version of Senate Bill 1051 of 2014 as passed by the House of Delegates.

Appendix 1

The logo for MRC (Maryland Radio Company) consists of the letters "MRC" in a bold, white, sans-serif font, centered within a solid black rectangular background.

Honorable Governor Martin O'Malley
State House
100 State Circle
Annapolis, MD 21401

Dear Governor O'Malley,

Thank you again for taking the time to visit the *House of Cards* set last spring to announce the enhancement of the Maryland Film Production Employment Act. The passage of the legislation allowed MRC and the production to remain in Maryland. We appreciate your strong support for our business and for recognizing the jobs and economic impact it brings to the State of Maryland.

We know that the General Assembly is in session, and understand legislation must be introduced to increase the program's funding. MRC and *House of Cards* had a wonderful experience over the past two seasons and we want to stay in Maryland. We are ready to assist in any way possible to help with the passage of the bill.

In the meantime I wanted you to be aware that we are required to look at other states in which to film on the off chance that the legislation does not pass, or does not cover the amount of tax credits for which we would qualify. I am sure you can understand that we would not be responsible financiers and a successful production company if we did not have viable options available.

We wanted you to be aware that while we had planned to begin filming in early spring, we have decided to push back the start date for filming until June to ensure there has been a positive outcome of the legislation. In the event sufficient incentives do not become available, we will have to break down our stage, sets and offices and set up in another state.

Thank you again for the support and assistance that *House of Cards* has received from the State of Maryland and your agencies, Baltimore City, as well as Harford County, the Maryland Film Industry Coalition, the unions, and Maryland's citizens and thousands of small businesses. I hope this legislative session will be successful and that you will be able to visit *House of Cards* and spend time with our cast and crew once again.

Sincerely,

A handwritten signature in black ink, appearing to read "Charlie Goldstein", with a long horizontal flourish extending to the right.

Charlie Goldstein
Senior Vice President, Television Production

Cc:

Dominick Murray, Maryland Department of Business and Economic Development
Hannah Byron, Maryland Department of Business and Economic Development
Jack Gerbes, Maryland Film Office
Debbie Dorsey, Baltimore Film Office