FACTS AT A GLANCE

The $60 Million Movie Industry Tax Cut

On July 12, 2005, the House of Representatives approved a bill (House No. 4252) to provide several different tax incentives for motion picture production in the Commonwealth. According to the Revenue Impact Analysis released by the Department of Revenue on July 15 – three days after the House considered the bill – those incentives, when taken together, would reduce FY 2006 tax revenue by as much as $60.6 million and would produce similar revenue losses in future years. If the upper bound of the Department's projections is realized, House 4252 would become the largest tax cut enacted by the Legislature in five years. In general, House 4252 runs counter to one of the central fiscal policy lessons of the past decade – namely, that permanent tax cuts enacted in response to short-term economic trends can seriously jeopardize the Commonwealth's long-term fiscal outlook. In particular, House 4252 would create a relatively sizable set of tax credits, credits that would not only permit companies to receive two separate tax reductions for the same expenses, but that could also enable companies outside of the film industry to receive substantial tax reductions as well.

Among its principal provisions, House 4252 would create:

1. **A tax credit, for motion picture production companies with expenses below $10 million, equal to 15 percent of the payroll paid to Massachusetts residents; the credit would rise to 20 percent of payroll for companies with expenses in excess of $10 million.** According to the Department of Revenue (DOR), this credit would result in a revenue loss of $8.9 million to $13.3 million in FY 2006, with losses of similar magnitude in subsequent years.[1]

2. **An additional tax credit, equal to 25 percent of a motion picture production company's Massachusetts production expenses, provided that the company either (a) had Massachusetts production expenses equal to or greater than 50 percent of its total production expenses or (b) spent 50 percent or more of its "principal photography days" in the Commonwealth.** DOR estimates that this additional credit could produce a revenue loss of up to $46.2 million in FY 2006, but cautions that its effect might not be so large, given the assumptions that underpin the Department's Revenue Impact Analysis. However, the Department's analysis is based on an earlier version of the bill that made it more difficult to qualify for this particular credit; an amendment adopted during the House debate on the bill relaxes the criteria under which companies may claim the credit, thus increasing the likelihood that DOR's projection will be realized. This credit too would result in revenue losses each and every year into the future.

[1] Massachusetts Department of Revenue, *Revenue Impact Analysis: An Act Providing Incentives to the Motion Picture Industry*, July 15, 2005.

3. **An exemption from the sales tax for any purchases of tangible property made by a qualifying motion picture production company.** DOR projects that this element of House 4252 would result in a loss of sales tax revenue of $0.7 million to $1.1 million in FY 2006, with, again, losses of similar magnitude in subsequent years.

The combined effect of the two tax credits created by House 4252 is to provide an enormous payroll subsidy for motion picture production in Massachusetts. The same payroll expenses eligible for the 15 or 20 percent payroll tax credit would also be eligible for the 25 percent credit for production expenses. As a result, any company with Massachusetts production costs in excess of $10 million, provided that those costs are at least 50 percent of its total production costs or provided that the company spends 50 percent of its principal photography days with the Commonwealth, would enjoy a ***45 percent*** payroll subsidy. In other words, under such circumstances, the Commonwealth would pay $22,500 for someone making a $50,000 salary or $112,500 to someone making $250,000. It is worth noting as well that the two principal tax incentives in House 4252 are credits, not deductions, and are calculated as a percentage of expenses, not taxes owed, thus making them far more valuable to production companies and, by definition, more expensive for the Commonwealth.

Overall, the tax provisions of House 4252 would reduce revenue in the current fiscal year by as much as $60.6 million. To put this in perspective, consider that, according to the Commonwealth's Tax Expenditure Budget for FY 2006, these tax breaks could end up being roughly 30 times as large as the "Jobs Incentive Payment for Biotechnology and Medical Device Companies" created in 2003. In fact, they could ultimately prove to be larger than the Commonwealth's Investment Tax Credit, which is expected to reduce corporate excise revenue by $49.3 million in FY06, and nearly as large as its Research Credit, which is anticipated to lower corporate excise revenue by $76.0 million this fiscal year. Of course, these tax breaks appear just as sizable when compared to appropriations intended to promote Massachusetts and to attract employers to the Commonwealth. They could end up being more than triple the amount allocated to the Office of Travel and Tourism in FY06 – $16.4 million – and over forty times the amount provided for the Office of Business Development – $1.3 million. While some are sure to maintain that the loss of up to roughly $60 million in taxes will be offset by the additional revenue generated by increased economic activity, the Department of Revenue, as a matter of course, does not use dynamic scoring in its Revenue Impact Analyses; thus, the burden of proof lies with proponents of the measure.

House 4252 does limit the total amount of credits a company can receive for a given motion picture production to $7 million. Yet, it permits motion picture production companies to sell some or all of their tax credits to other taxpayers in the Commonwealth. Presumably, the provisions allowing the sale of tax credits are included in the bill because, in some instances, companies will receive much more in tax credits from the Commonwealth than their total tax liabilities.

House 4252 also acknowledges the need to assess whether the changes in tax law it contains achieve the economic goals set for them. Section 7 of the bill requires the Secretary of Economic Development to conduct an "economic impact study of motion picture production and development" and to issue the results of that study no later than the end of 2009; the bill also mandates annual reports by both the Commissioner of Revenue and the Secretary of Economic Development as to the number of tax credits issued and the economic activity in which recipients of the credits engage.

Unfortunately, Massachusetts has a dismal track record of evaluating the economic effectiveness of tax incentives. For example, when the Commonwealth instituted its "single sales factor" apportionment formula for manufacturers and mutual fund companies in the mid-1990s, it stipulated that the Commissioner of Revenue produce an annual report examining the impact of that particular tax incentive on the industries that benefited from it. As of last year, however, the Department had completed just five of the fourteen reports that should have been issued by that time. Similarly, legislation enacted in 1996 mandated that the Joint Committee on Taxation study the effectiveness of Massachusetts' investment tax credit. In its report issued in June 1997, the Committee noted that the information provided to it by businesses about the economic impact of the tax credit was largely anecdotal in nature, while the information provided by the Department of Revenue was either inconsistent or incomplete. Consequently, the Committee concluded that it "cannot recommend that the investment tax credit be increased permanently to three percent at this time … It would be premature to recommend [doing so] without further analysis of the issue …"[2] Despite the Committee's report – and the absence of any further official analysis of the tax credit – it was increased permanently in 2003.[3]

In light of this record, the Commonwealth might be able to protect itself against permanently providing an inefficient and ineffective subsidy for movie production by requiring that the provisions of House 4252 expire – or "sunset" – on a certain date unless the Legislature acts to renew them. Some might argue that permitting tax credits to expire in this fashion would introduce a measure of uncertainty into the tax code, but, given that the production of a motion picture is a discrete, one-time event, as opposed to a continuing series of capital investments, a "sunset" is particularly appropriate. In fact, this approach would simply put the tax incentives contained in House 4252 on the same footing as the billions of dollars in appropriations the Commonwealth makes each year. "Sunsetting" would permit legislators to determine whether the tax incentives in House 4252 are meeting the goals established for them at a reasonable cost and whether the cost is appropriate given other potential uses of the revenue that the Commonwealth would forego if the tax incentives were renewed.

[2] Memorandum from Senator Warren E. Tolman and Representative Peter Larkin to the Members of the Joint Committee on Taxation, June 2, 1997, p. 2.
[3] For more on this topic, see the MBPC's April 2004 report, *Tax Expenditures and Economic Development*, available at http://www.massbudget.org/econdev.pdf.