



Film Financing and Tax Policy

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Is there something amiss when the film adaptation of a national book award winner about the American Civil War is filmed in Romania? Perhaps it is part of the magic of the movies that a post-Soviet era Eastern European country can be made to look like Appalachia, but the magic of the movies costs money. And money may be the primary reason a multimillion-dollar movie starring Nicole Kidman, Renee Zellweger, and Jude Law was shot overseas.¹

As costs rose and corporate ownership of movie studios increased, the bottom line became of paramount importance.² On the one hand, as one industry expert stated, “The two constant forces driving film financing are blockbuster optimism and the sexiness of the industry.”³ A certain amount of financing may be attracted to a project by dreams of high returns or the glamour of a producer credit.⁴ On the other hand, tax policy is also a constant factor influencing which films get financed and how.⁵

A producer must keep in mind the taxation of private equity and business entities when making decisions related to film financing.⁶ Beyond general tax policy, however, producers also have special tax incentives to consider.⁷ They may utilize tax credits,⁸ subsidies,⁹ and/or tax shelters as part of their film financing.¹⁰ However, the use of such incentives may impact where a given film will be shot and where post-production will take place, expanding the implications of tax policy for film production from financing decisions to creative choices as well.

Given the increased mobility of filmmaking due to technological advances (i.e., better, smaller equipment) and global communications infrastructure, states are perpetually vulnerable to production loss.¹¹ When a film is developed in one state or country but is produced in another, it is called a “runaway production.”¹² Such a production may be an “artistic runaway,” “natural economic runaway,” or “artificial economic runaway.”¹³

An artistic runaway production is compelled by creative choices, such as when a producer or director wants to capture a particular setting for a film by shooting in that location.¹⁴ This phenomena is unique to film and unlike any other industry except perhaps natural resources like oil and minerals, which are constrained to where the resources are buried. Whereas other industries make location decisions based primarily on economic factors like input costs, wage rates, and taxation, a certain amount of filmmaking has always located itself in the environment it wants to portray on screen, which is unlikely to change. However, an increasing number of runaway productions are being motivated by the very same considerations that

drive other industries: the costs of doing business. As a result, economic reasons now outweigh creative motivations for runaway productions.¹⁵

When a film relocates from the state or country in which it was developed in order to take advantage of naturally occurring lower production costs, it is deemed a natural economic runaway.¹⁶ Such a production may seek to capitalize on favorable exchange rates, lower wage and labor costs,

and cheaper inputs.¹⁷ While those runaways are responding to “natural economic occurring phenomenon ... that lower production costs,” artificial runaways are based on “legislatively created incentives designed to lure productions.”¹⁸ Hence artificial economic runaways are specifically instigated by tax policy.¹⁹

Runaway production is not a new phenomenon, though the trend historically was toward creative or naturally economic runaways.²⁰ In the last few decades, however, the balance has shifted toward artificial economic runaways.²¹ Countries seeking to attract film production in an effort to create jobs and spur economic growth have implemented various tax schemes to that end.²²

Tax Incentive Schemes

Canada seems to have started it all, implementing incentives designed to lure film productions, particularly from the United States, and to some extent they have succeeded: Canada is often called “Hollywood North.”²³ Between provincial and national tax incentives, productions may secure credits for up to 70 percent of in-country labor costs and up to 30 percent in tax incentives for qualifying local expenses.²⁴ Combining such labor and expense credits with rebates based on labor costs and production services credits, a film could save up to 25 percent of its budget by relocating production to Canada.²⁵

While general economic trends such as exchange rates and cost of labor certainly impact the choice of production location, in this instance Canada’s incentive programs appear to have heavily influenced production location decisions.²⁶ As a case in point, in the year following Canada’s establishment of its incentive program, dollar volume of feature film production rose 144 percent in the country, without any significant change in either the exchange rate or cost of labor.²⁷ Additionally, declines in film industry payroll in California during the 1990s and early 2000s corresponded with Canada’s establishment of tax incentives for film production in the same period.²⁸ Canadian officials often cite such statistics as evidence of their policies’ effectiveness.²⁹

Although correlation is not causation, the correspondence between Canada's policies, explicitly intended to incentivize runaway production, and the occurrence of just such a result suggests that tax schemes do generate some amount of artificial economic runaways. Anecdotal evidence from specific producers affirms this inference, as do statistics documenting the flight of film production from the United States in the past few decades as other countries (and even states) followed Canada's lead and implemented their own production incentives.³⁰

Throughout Europe, countries have offered a variety of tax-based inducements for film, often in efforts to best their neighbors.³¹ Within Eastern Europe, several countries have offered competing incentives in efforts to attract runaway films.

The Czech Republic has offered a 20 percent cash rebate for qualifying in-country spending and a 10 percent rebate for international costs including post-production.³² An additional 66 percent rebate on salaries paid to foreign cast and crew has been available when minimum domestic expenditures are met and the salaries are subject to domestic tax withholding.³³ Despite these favorable tax policies, however, the Czech Republic has had to compete with its neighbors to draw productions to its borders, and sometimes it has lost. For example, "Cold Mountain," originally planned for filming in the Czech Republic, relocated to Romania instead due to the lower labor costs and production incentives.³⁴

Hungary has also outbid other Eastern European countries by offering tax credits for up to 30 percent of in-country expenses.³⁵ Steven Spielberg shot "Munich" in Hungary, instead of Germany, in part because of tax incentives.³⁶ Not to be outdone, smaller countries in the region, including Estonia, Lithuania, Macedonia, and Croatia have all instituted their own incentive schemes, with varying success.³⁷

On the other side of the continent, the United Kingdom and Ireland established incentive programs to encourage runaway productions to come to their shores.³⁸ The United Kingdom offers tax credits of up to 20 percent of a film's overall budget for a variety of expenses, including talent salaries.³⁹ At the same time, Ireland offered a 32 percent tax credit to Irish production companies or branches residing in-country.⁴⁰ As such, while the "Harry Potter" franchise and "Charlie and the Chocolate Factory" filmed in the United Kingdom, Ireland nabbed "Braveheart" and "The Count of Monte Cristo."⁴¹

A world away, two other island nations proffer production incentives that have drawn some of the biggest blockbusters of the past decade. Australia has rebated up to 40 percent of in-country production costs and 30 percent of post-production costs paid in-country, regardless of where the film itself was shot. The only requirement is that the film secure a theatrical release deal in Australia as well as a prints and release agreement with an Australian distributor.⁴²

Although much smaller in terms of landmass, New Zealand bested its larger neighbor in the early 2000s when it nailed the "Lord of the Rings" trilogy. The film series received tax breaks of over \$100 million, mostly through a "loophole" that allowed shell companies established in-country as "owners" of the film to then "sell" the completed work back to New Line Cinema.⁴³ "Lord of the Rings" was not the only high-profile film to be shot in New Zealand, however. With the availability of a 12.5 percent cash rebate for qualifying films, "King Kong" and "The Lion, The Witch and the Wardrobe" all completed principal photography in New Zealand, receiving rebates of \$16.6 million and \$10.3 million, respectively.⁴⁴

Although the "loophole" taken advantage of by "Lord of the Rings" is no longer available, New Zealand's government instituted other incentives to encourage film production within its borders.⁴⁵ The government rebates 20 percent of eligible costs for productions with a minimum budget of \$11 million, with an additional 5 percent available based on proof that the production will benefit New Zealand's economy.⁴⁶

Tax incentives for film production also extend into Latin and South America. For example, Panama gives a 15 percent rebate for a minimum of \$3 million in local expenses. Colombia offers rebates for up to 40 percent of film service expenses and up to 20 percent of logistical costs, with the requirements that the film is shot in part in Colombia and has a minimum budget of \$600,000. Across the Caribbean, Puerto Rico, the Dominican Republic, and Trinidad and Tobago all offer various rebates and credits based on qualifying expenses and local spending.⁴⁷

A hemisphere away, South Africa offers a 20 percent tax credit on production expenses and a 25 percent credit for post-production costs. Principal photography must take place exclusively in South Africa and at least \$1.5 million must be spent in-country. South Africa also has a number of regional film funds.⁴⁸

Paralleling the production incentive war taking place on the global stages, dozens of U.S. states have engaged in a battle of inducements all their own. New Mexico and Louisiana started the trend by following Canada's example and offering credits of up to 25 percent of production costs.⁴⁹ Subsequently, both states saw an immediate spike in film productions shooting within their borders, causing other states to take notice and follow suit.⁵⁰

For many years, North Carolina "consistently ranked as the third highest production center in the country,"⁵¹ offering a credit of up to 25 percent to productions filming in state.⁵² However, as other states began to implement tax policies designed to attract runaways, North Carolina saw in-state production decline 63 percent.⁵³ Then, when North Carolina scaled back its program, Georgia stepped into the void. Producers in Georgia can receive up to 30 percent off of taxes based on qualified spending,⁵⁴ which may include costs of both in-state and out-of-state workers.⁵⁵ An initial credit of 20 percent of production costs is available, with an additional 10 percent if the producer includes the state's logo; such tax credits are transferable.⁵⁶

While Georgia and North Carolina have been battling it out for film production in the southeast, Wisconsin implemented an incentive program in hopes of creating permanent jobs in the film industry. Its program offers a nonrefundable tax credit of 25 percent of Wisconsin salaries and a nonrefundable credit of 100 percent of state sales taxes. Additionally, a 25 percent refundable tax credit of 25 percent of certain out-of-state salaries and production purchases is available. Further south, Iowa offered its own tax incentives for principal photography, leading the state's film office to promote the program as "half-priced" filmmaking.⁵⁷

In the northeast, a number of states—including New York, Massachusetts, and Rhode Island—have offered various incentives to attract principal photography, with mixed results. While Rhode Island was able to draw Wesley Snipes's film "Hard Luck" by providing \$2.65 million in state tax credits, in the end only \$1.9 million of the film's \$11 million budget was spent in-state.⁵⁸

Despite being a relatively low-tax, business-friendly state, even Texas has offered incentives to attract film production. In general, the state provided tax credits as a way for businesses to lower their

costs and increase their in-state investment, with the ultimate goal of creating more jobs. Desiring to create in-state jobs and infrastructure in the film industry specifically, Texas decided to offer tax credits to increase principal photography in the state. Consequently, in 2005, Texas established its Texas Moving Image Industry Incentive Program, which made \$20 million in incentives available in 2007-2008 and 2009-2010, with an additional \$40 million added in 2009-2010.⁵⁹

Even California was eventually forced to offer inducements to film in the state, and in 2001 it established the Film California First program to provide a number of incentives for filming in-state, including cash rebates of up to \$300,000, reduced fees to shoot on public property, tax exemptions, traffic control, and assistance coordinating with local film commissions in production planning.⁶⁰ Additionally, the state offered a tax credit worth 25 percent of the qualified costs of an independent film production.⁶¹

Nuanced Programs, Complex Causes

It is difficult to assess the efficacy of film production incentives generally and particularly thorny to compare programs, given the many differences in program structure, administration, features, and content. There is discrepancy between favorable studies undertaken by trade groups and state film commissions and critical studies conducted by independent, outside institutions.⁶² As a result, there is no consensus as to whether incentive programs are good or bad, underscoring this article's thesis that such consensus is impossible because of the nuances involved.

It is unclear whether state incentives are retaining productions that might otherwise be lured overseas or simply redistributing productions within the United States.⁶³ Most state film subsidies are structured as tax credits⁶⁴ and in some instances production companies are able to claim credits even if money is lost on the film, which is true of the majority of productions.⁶⁵ The median subsidy provided by state tax incentives amounts to one quarter of qualified production expenses.⁶⁶ Many states have structured their credits to be transferable or refundable; transferable credits may go to any entity with tax liability in the state, regardless of its line of business.⁶⁷ However, despite the immediate benefit to the producer from a transferable credit that can be sold to cover present production costs, in the long run transferable credits are particularly problematic because the costs to the state may take years to emerge since the holder has several years over which it may claim the credits.⁶⁸

Ultimately, it appears the direct cost of film subsidies outstrips the revenue raised, requiring states to either cut expenditures elsewhere or find other sources of funding.⁶⁹ In the first decade of the 21st century, states offered more than \$6 billion in tax incentives to film production.⁷⁰ However, such tax breaks benefit the film industry more than the states themselves, resulting in a wealth transfer from taxpayers to studios.⁷¹

"Beggars thy neighbor" competition between states via film tax incentives have cost more than they've provided in benefits.⁷² Competition is high, which, when combined with the inherent riskiness of film production and its project-based structure, makes production tax incentives a suspect strategy for long-term economic growth.⁷³ Credits "work" in terms of attracting productions but fail to create long-lasting, stable jobs for local residents⁷⁴; most jobs are transplanted from other states and do not last beyond an individual production.⁷⁵

Beyond the questionable economics of tax incentives for film production, in general state programs have not been subject to

standard oversight⁷⁶ and several programs have been wracked by scandal and official misconduct.⁷⁷ 2011 saw a turn in the tide of state tax programs for film. Arizona put an end to its program; Arkansas, Idaho, and Maine did not set aside any funds for their programs; and Iowa, Kansas, and New Jersey suspended their programs. Many other states have scaled down the benefits offered by their programs and some, including Georgia, Michigan, Missouri, and Rhode Island, proposed outright elimination.⁷⁸

Facing the onslaught of production incentives both at home and abroad, the U.S. federal government has offered different legislative and policy responses, none of which have ended the war between the states (which appears to have cooled largely due to poor outcomes) or slowed the outflow of production to other countries.⁷⁹

From 1998 to 2005, the United States lost production expenditures, number of productions, and market share of productions to other countries.⁸⁰ Despite the 30 percent growth in production expenditures globally from 1998 to 2005, in the United States during that period, those same expenditures dropped 14 percent.⁸¹ Studio-financed feature productions fell by 17 percent in the United States from 1998 to 2005, while it rose 85 percent worldwide during the same period.⁸² The number of feature films shot in the United States fell more than 20 percent in the period 1998-2005, while the number filming outside the U.S. grew 55 percent.⁸³ An estimated one-third of feature films developed in the United States in 2005 were filmed overseas, while 45 percent were filmed outside the United States in 2004.⁸⁴

In the years since state and federal governments have taken steps to respond to runaway production, the "problem" has clearly not been solved.⁸⁵ Ultimately, runaway production can only be dealt with by first diagnosing the "problem" accurately. As one expert observed, "Solutions [to runaway production] will not be simple because the causes are several and very complex."⁸⁶ Policy makers must distinguish between what is harmful tax competition necessitating a government response and what is simply the result of market forces. "Accepting that runaway production will occur and dealing with the consequences may be a more prudent approach than trying to direct the economics of the entertainment industry."⁸⁷

All of the foregoing requires a more nuanced understanding of the film industry and the specific factors at play in runaway production, as well as what is achievable in response to such productions for different levels of government.

Factors to Consider

The film industry has a number of unique characteristics that have implications for runaway production and policy responses to the phenomenon. Firstly, film is produced in stages and financing may mirror this multistep process. Pre-production involves all the planning and logistical preparation for a film to actually be shot. Typically, a producer will obtain rights to film a script or have a script developed, then get commitments from a director and key cast members to participate in the project.⁸⁸ This package of script, director, and leading actors is then used to raise funds for the budget. Once financing is obtained, the rest of the cast and crew can be fleshed out, and all logistics for the shoot, including dates and locations, are set.

Actual filming, called principal photography, is stage two of a production. This is when most of the film's budget is spent, as well as when a given film is most likely to run over budget. Once principal photography wraps, the film moves into post-production. The editor

takes the raw footage from stage two and cuts it all together into the final film. Additionally, all special effects and computer-generated imagery are added in, adjustments are made to the footage, the sound is edited and mixed, and the score layered in. Opening and closing credits bookend the final film that emerges from post-production ready for distribution and exhibition, which is the fourth and final stage in a film's lifecycle. There may be multiple rounds of distribution and exhibition, from an initial theatrical release or airing on television to release on DVD, direct-to-digital, and/or exhibition on airlines, cruise lines, and military bases.

Throughout a film's lifecycle, there are a number of categories of spending that may be treated differently for tax purposes. Primarily there are wage expenditures, either salary or hourly payments, which are often accompanied by benefits, including insurance and pension outlays and, in the case of above-the-line talent, residuals and perks like dressing rooms, security, and personal fitness facilities.⁸⁹ Above-the-line cast members are the stars of the film, while below-the-line cast members include all bit players, stunt men and women, and extras. Below-the-line crew members are all of the technicians that make a film possible, from grips and gaffers to best boys, production assistants, costume designers, hairdressers, and makeup artists.

Aside from wages, a variety of production expenses are also incurred in the making of any given film, including location fees, equipment rentals, catering, lodging, transportation, and dry cleaning. Many of these costs go to the support industries that make film possible and it is these expenditures that are generally credited with the "multiplier effect" associated with film production.

Most of the foregoing spending takes place during principal photography, but postproduction also has its fair share of costs. Special effects houses and sound mixing companies must be paid, as well as the editor(s) and composer. During post-production, the producer will undertake a promotional campaign to generate audience anticipation for the film's release. And when the film is finished, copies of the final film must be made and distributed, whether to theaters, retailers, streaming platforms, or cable and broadcast companies.

Films are produced at multiple levels within the industry, from the six major studios to numerous independent studios or small teams of individual filmmakers.⁹⁰ Likewise, there are multiple layers of competition for film productions, from countries and states vying to attract films to counties and cities seeking to draw productions to their municipalities.⁹¹

Recommendations

Runaway film production is a multifaceted phenomenon, with multiple causes and even more effects. To the extent that government wants to respond to runaway production, it must first diagnose the "problem" accurately. Given that "traditional economic theories employed to study other American industries ... are not well-suited to study the entertainment industry," any government response must be tailored to the correct cause of the runaways at hand.⁹²

As a threshold step, a government wanting to respond to runaway production could first make its business environment generally more favorable to film production.⁹³ The government should also consider how current tax policy impacts film production. At present in the United States, federal income tax laws impose a number of burdens upon the American film industry: tax deductions cannot be taken in the same time period as when revenues are generated and accelerated

depreciation is not applicable to films and home video.⁹⁴ Where tax credits are available but not transferrable, their utility for film production is severely limited because a producer's primary need is immediately available cash to cover production expenses.⁸ Foreign income tax imposed upon repatriation also has implications for film production, particularly considering the fact that several large production companies have subsidiaries in countries offering production incentives.⁹⁵ To the extent that these companies earn income overseas through their subsidiaries, current tax policy may discourage them from bringing that income home, instead encouraging them to keep those funds abroad for investment in future runaway productions.

Once the government has taken stock of the impact its current policies have upon film production, it can proceed to an examination of runaway production in particular. If runaway production is primarily the result of creative choices, any attempt to thwart such choices would be nonsensical and potentially pose a threat to free speech. Similarly, if producers are moving principal photography overseas in order to take advantage of a favorable exchange rate or lower labor cost, any government effort to counter these economic realities, if naturally occurring, would result in inefficiencies as objectionable (if not more so) as runaway production itself.

Consequently, the only type of runaway production that governments should be concerned about are artificial economic runaways, which are induced by the tax policies of other governments. To the extent that harmful tax competition is instigating runaway production, a government may want to respond to lessen the detriment caused.⁹⁶ However, in its response, the government must clearly identify its goal and how to assess the success or failure of its policy.

For example, the goal might be to lower the number of films or amount of production expenditures made in countries offering tax incentives to runaway filmmaking.⁹⁷ In order to achieve its goal, the government could add the value of the incentives received to the calculation of a recipient's tax liability, disallow U.S. tax credits up to the amount of foreign incentives received, prohibit tax deferral for any project receiving foreign incentives, disallow deductions up to the amount of the foreign incentives received, or disallow foreign tax credits up to amount of foreign incentives received.⁹⁸

Alternatively, allowing production companies to expense their total cost of production might help stem the tide of runaway production. Although a film typically generates the most revenue within the first year following initial release, it may take a film years to turn a profit, if it does at all. Permitting all production costs to be expensed in the first year would enable a film company to regain its basis within 12 months of incurring the costs. The more quickly a production company can regain its basis, the more quickly it can reinvest in new projects, making deduction of expenses a preferred policy option. Capitalizing expenditures or allowing production costs to be depreciated at accelerated rates are alternative options, though less valuable because the basis is regained more slowly as compared to deductions.⁹⁹

The foregoing policy options are intended to quell the number of productions or magnitude of production expenditures going overseas. If, instead, the government wishes to encourage long-term job growth, it should focus on pre- and postproduction, rather than principal photography, because these phases are more stable and lend themselves to establishing a permanent industry presence.¹⁰⁰

The United Kingdom has done just that, and to great effect, as a sizeable percentage of the visual-effects sector has relocated to the United Kingdom from Los Angeles.¹⁰¹ The three largest visual-effects

companies, all based in the United Kingdom, generate more than \$330 million in revenue yearly and won Oscars for best visual effects in 2013 (“Gravity”), 2014 (“Interstellar”), and 2015 (“Ex Machina”).¹⁰² Additionally, U.K. visual effects houses have taken advantage of lucrative tax incentives in Canada and set up divisions there.

As a result, it appears that incentivizing post-production may actually have the multiplier effect that many proponents of favorable tax policies for film production claim. For example, “A Night at the Museum” was originally to be shot in Montreal but left Quebec for British Columbia’s Vancouver in order to retain a tax break on its post-production visual effects costs.¹⁰³ Consequently, not only did Vancouver secure the post-production jobs on the film, which was the purpose of the tax policy that instigated the move, but it also nabbed principal photography and the jobs created during the filming phase.

Any multiplier effect provided by post-production can be expected to grow in magnitude as digital effects become an increasingly important (and expensive) part of film production. For the average \$100 million feature, computer-generated visual effects amount to one-third of the budget.¹⁰⁴ “The Jungle Book” is an extreme example, without any outdoor film locations and all scenery being computer-generated.¹⁰⁵ Additionally, the technical skills required for post-production work may be more transferrable than camera skills, lighting, or on-location sound recording since post-production is computer-based and may provide a foundation for expansion into graphic design, animation, coding, or web development.

Although post-production skills may lend themselves more to transitioning into other (digital) sectors, in the event a government wants to attract principal photography, it could focus its policy on increasing the transferability of skills utilized during filming. The technicians, electricians, and carpenters that work on set or on location could be given educational credits to increase their training and trade certifications. Alternatively, a co-op program could be established through a public-private partnership wherein workers are matched with companies that provide apprenticeships and support employees’ transition into new employment. By building a crew base with diversified skills that could more easily transition into other lines of work, a jurisdiction could provide for more sustainable employment while also being a viable location for principal photography.

Beyond providing support for post-production and for principal photography in a limited and future-oriented way, a government may also consider supporting pre-production in order to increase the number of projects that are made. One way to do so would be to expand the sources of funding for film, as was recently attempted by the 2012 JOBS Act that sought to enable crowdfunding via increased private securities offerings.¹⁰⁶ If producers were able to promote their projects more widely and thereby increase access to funding sources, more films might be made.¹⁰⁷ In addition to making private equity more accessible, a government wanting to expand access to film financing could craft policy that makes foreign investment in film production easier and less costly.¹⁰⁸

However, any policy focus on pre-production should also consider the market forces at work during this initial phase and how any policy might distort production choices and increase inefficiency by lessening the cost of net-loss projects. As has been discussed, many films lose money and in some instances production companies structure their slate of projects specifically for the purpose of internal subsidization. Given this state of affairs, pre-production is

a vital gatekeeping stage, wherein some number of projects manage to garner sufficient support to be undertaken and the rest do not. In that way film production is like any startup looking for angel investors. Whether a given film obtains the funding it needs hinges upon a variety of factors, including the producer’s track record and reputation, the existing relationships and network the producer has and is able to leverage, the potential benefits offered to funders, and of course the merits of the film itself.

To the extent that policy removes or lessens the effectiveness of any of these initial checks, there may be an increase in the number of “losing” films produced. However, if producers were able to reach more potential funders, perhaps through crowdfunding, then the increased awareness of the project itself could redound to increase revenue. In any event, a government wanting to support increased funding for film production should carefully analyze how the market forces particular to the industry operate and how its policy options might impact those forces. Implementing a pilot program and carefully monitoring its effects would be a wise first step.

Possible Government Responses

Within the federal system of the United States, responses to runaway production have been undertaken at the municipal, state, and national level. Any government within the American system must consider whether it is the appropriate level of government to respond to the runaway production that it faces.

It seems obvious that, on the whole, the responses made by state governments have been ineffective, inefficient, and harmful, particularly in the constrained budget environment of the last decade.¹⁰⁹ Instead of tailoring tax incentives to particular sectors, states should craft policies that are favorable to industry generally.¹¹⁰ For example, Nevada, Delaware, and New Hampshire do not offer tax incentives for film production, but also do not tax corporate or individual income (Nevada), do not have sales tax (Delaware), and do not tax wages or sales (New Hampshire).¹¹¹ These across-the-board policies may increase the general competitiveness of the state for businesses that can most benefit from the policy while also allowing market forces to direct industry investment without the inefficiencies caused by sector-specific incentives.

Whatever choice a state makes in terms of its tax and spending policies (and perhaps this is stating the obvious), it should not expend more than it benefits on any given policy. The last two decades have seen states engaged in a subsidy war to attract principal photography that mirrors the “gamemanship” typical of manufacturing incentive wars.¹¹² This recent explosion of intrastate competition has produced the crazy result of states fighting toward insolvency instead of banding together in a national approach to compete against other countries.⁷²

To the extent that the runaway production that is causing harm to the U.S. film industry and its workers is artificial economic runaway production spurred by the favorable tax policies of foreign governments, a national response may be both necessary and appropriate. As a threshold matter, the government could address the harmful competition caused by other countries’ tax policies. One option would be to initiate an action against foreign policies thought to contravene World Trade Organization (WTO) obligations.¹¹³ Alternatively, the federal government could seek to negotiate cooperative policy, most likely through bilateral channels but potentially through multilateral discussions, perhaps facilitated by the World Intellectual Property Organization in conjunction with WTO.

At home, the government, and perhaps most effectively consumers, could encourage the industry to implement its own solutions. Lower salaries for above-the-line talent would reduce production costs, making domestic production more affordable and reducing the need to offset such high costs with tax incentives and subsidies. However, asking anyone to take a pay cut in order to benefit others is a hard ask, but there are instances in which high-profile talent has chosen to make personal sacrifices in order to keep a production at home.¹¹⁴ Thus the choice is not unprecedented and may provide favorable public-relations for the production as well as reputational gains for the talent that could confer benefits into the future.

A government considering a policy response to artificial economic runaway production should take into account not only the particular causes of runaways that it is trying to address and what response is appropriate at its particular level, but also identify who is the intended beneficiary. If the six major studios, who undertake the bulk of production in terms of both magnitude and expense, are the targeted beneficiaries, incentives will have to be on a much larger scale than if independent studios or individual filmmakers are meant to benefit.¹¹⁵ By contrast, if instead of benefitting major studios a government wants to promote native filmmaking, it may choose to directly subsidizing domestic filmmaking. Some foreign government have chosen this route in an attempt to offset the competitive disadvantage to their native producers from the American film industry.¹¹⁶

Beyond setting its sights on a particular class of producers, a government responding to artificial economic runaways may wish to institute policy that benefits below-the-line workers specifically. It is likely not the stars who need help weathering the storm of runaway production, but the supporting cast and crew: "The bulk of the industry is below the line and that's what's hurting."¹¹⁷ Hence, if a government wants to aid below-the-line workers, it could implement general policies to increase wage competitiveness and/or provide retraining programs for displaced or temporarily employed production workers.¹¹⁸

Conclusion

So back to the original question: Is there anything wrong with "Cold Mountain" filming in Romania, "The Blues Brothers" being shot in Canada, or "Superman" conducting principal photography in Australia? Well, that depends on who you ask. Runaway production is a hydra-headed trend with multiple and difficult-to-identify causes and effects. Any government seeking to respond to this phenomena must tread carefully, identifying exactly what harm it is seeking to alleviate, whether it is suited to doing so and how such an effort can be made in a sustainable, effective, and efficient way. Every jurisdiction, from municipalities to states, provinces, regions, and countries, is distinct and what works in one may not in another.¹¹⁹ Moreover, in some instances, tax incentives may not be able to compete with favorable exchange rates, lower labor costs, and foreign tax incentives.¹²⁰ A government wanting to implement a policy response to runaway production would be well-advised to focus on artificial economic runaways and address the root of the issue first: harmful tax competition from foreign governments. To the extent that such harmful competition can be lessened or done away with, a government may then focus on its competitive assets, including a skilled workforce, sophisticated infrastructure, reliable public goods, and generally favorable tax policy. ©



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⁶Michael L. Maddren, *Choice of Entity and Securities Aspects of Independent Offerings by First-Time Filmmakers*, 22 HASTINGS COMM. & ENT. L. J. 65, 67-72 (1999).

⁷Christopher H. Lytton, *Soft Money: The Weapon of Choice for the Runaways Productions*, 35 McGEORGE L. REV. 719, 727 (2004).

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⁹SCHUYLER M. MOORE, THE BIZ: THE BASIC BUSINESS, LEGAL AND FINANCIAL ASPECTS OF THE FILM INDUSTRY 21 (4th ed. 2011).

¹⁰Moore, *supra* note 8, at 30; Fayne, *supra* note 4, at 257-58.

¹¹Wicker, *supra* note 2, at 467; Robert Tannenwald, *State Film Subsidies: Not Much Bang for too Many Bucks*, CENTER ON BUDGET AND POLICY PRIORITIES (Dec. 9, 2010), <https://www.cbpp.org/research/state-film-subsidies-not-much-bang-for-too-many-bucks>.

¹²Adrian McDonald, *Through the Looking Glass: Runaway Productions and "Hollywood Economics"*, 9 U. PA. J. LAB. & EMP. L. 879, 900 (2007) (quoting Dr. Martha Jones).

¹³*Id.* at 900.

¹⁴Alexander Malyshev, *Financing Film Through Aggressive Tax Incentives—A Losing Proposition for the States?*, 19 MEDIA L. & POL'Y 229, 229 (2010).

¹⁵Wicker, *supra* note 2, at 468.

¹⁶See Mark Litwak, *Runaway Home: Production Incentives from Foreign Jurisdictions Are Playing an Increasing Role in Determining Where Films Are Made*, 27 L.A. LAW. 24, 24 (2004).

¹⁷Fayne, *supra* note 4, at 261; KATZ, *supra* note 1, at 54; Wicker,

supra note 2, at 486; McDonald, *supra* note 12, at 907-08.

¹⁸McDonald, *supra* note 12, at 900.

¹⁹Jeffrey S. Konvitz, *Independent Wealth: The Best Financing Opportunities for Independent Films Involve Complex Relations With Foreign Producers and Governments*, 27 44, 49 (May 2004).

²⁰Lytton, *supra* note 7, at 720-21.

²¹Battista, *supra* note 5, at 248-49.

²²Emily Buder, *The Best Countries in the World to Film Your Movie, Based on Production Incentives*, NO FILM SCHOOL (Aug. 22, 2016), <http://nofilmschool.com/2016/07/film-production-incentives-tax-incentives-movie-rebates>.

²³Kevin Lee, *The Little State Department: Hollywood and the MPAA's Influence on U.S. Trade Relations*, 28 N.W. J. INT'L L. & BUS. 371, 382 (Winter 2008)

²⁴Buder, *supra* note 22.

²⁵KATZ, *supra* note 1, at 34.

²⁶*Id.* at 4.

²⁷*Id.*

²⁸McDonald, *supra* note 12, at 916.

²⁹Claire Wright, *Hollywood's Disappearing Act: International Trade Remedies to Bring Hollywood Home*, 39 AKRON L. REV. 739, 754, 760-61 (2006). Tellingly, Canada's actors' union trains Canadian actors to speak with an American accent. In the past few decades, films shot in Canada include "Brokeback Mountain," "Good Will Hunting," "My Big Fat Greek Wedding," "Armageddon," "I Robot," and "Cinderella Man." *Id.* at 740-41.

³⁰*Id.* at 786.

³¹Lee, *supra* note 23, at 384.

³²Nick Holdsworth, *5 Eastern European Countries to Shoot Your Next Film and Save Money*, HOLLYWOOD REP. (Feb. 14, 2016, 12:00 AM), <http://www.hollywoodreporter.com/lists/5-eastern-european-countries-shoot-865044/item/eastern-europe-czech-republic-865046>.

³³Buder, *supra* note 22.

³⁴KATZ, *supra* note 1, at 53.

³⁵Holdsworth, *supra* note 32.

³⁶KATZ, *supra* note 1, at 57.

³⁷See Holdsworth, *supra* note 32; Buder, *supra* note 22.

³⁸See THE ECONOMIC CONTRIBUTION OF THE UK FILM INDUSTRY, OXFORD ECONOMIC FORECASTING (Sept. 20, 2005), <http://www.frsm.se/wp-content/uploads/2012/07/Oxford-Economic-forecasting-2005.pdf>.

³⁹*Id.* at 44.

⁴⁰Buder, *supra* note 22.

⁴¹KATZ, *supra* note 1, at 44-45.

⁴²Buder, *supra* note 22.

⁴³KATZ, *supra* note 1, at 51.

⁴⁴*Id.*

⁴⁵*Id.*

⁴⁶Buder, *supra* note 22.

⁴⁷*Id.*

⁴⁸*Id.*

⁴⁹Tannenwald, *supra* note 11.

⁵⁰*Id.*

⁵¹Wicker, *supra* note 2, at 495.

⁵²Erich Schwartzel & Cameron McWhirter, *Group Backed by Koch Brothers Takes Aim at Tax Credits for Films*, WALL ST. J. (Mar. 25, 2016, 3:32 PM), <https://www.wsj.com/articles/group-backed-by-koch-brothers-takes-aim-at-tax-credits-for-films-1458934367>.

⁵³*Id.*

⁵⁴Celeste Headlee & Trevor Young, *The Georgia Film Industry Fights to Keep Tax Incentives*, GA. PUB. BROAD. NEWS (Dec. 9, 2016), <http://gpbnews.org/post/georgia-film-industry-fights-keep-tax-incentives>.

⁵⁵Schwartzel & McWhirter, *supra* note 52.

⁵⁶*Id.*

⁵⁷Richard Verrier, *Iowa Film Tax Credit Program Racked by Scandal*, L.A. TIMES (Jan. 19, 2011), <http://articles.latimes.com/2011/jan/19/business/la-fi-ct-onlocation-20110119>.

⁵⁸Michael Cieply, *States' Film Production Incentives Cause Jitters*, N.Y. TIMES (Oct. 11, 2008), <http://www.nytimes.com/2008/10/12/us/12incentives.html>.

⁵⁹SUSAN COMBS, AN ANALYSIS OF TEXAS ECONOMIC DEVELOPMENT INCENTIVES 2010, TEXAS COMPTROLLER OF PUBLIC ACCOUNTS 59 (2010), <https://comptroller.texas.gov/transparency/local/docs/96-1453.pdf>.

⁶⁰Lytton, *supra* note 7, at 723-24.

⁶¹Moore, *supra* note 3, at 26.

⁶²Massachusetts previously offered a 25 percent tax credit to in-state film production. Cieply, *supra* note 58. However, the Department of Revenue subsequently found that \$88,000 in tax revenue was lost on each job created and held by a state resident. Additionally, up to 84 percent of compensation paid for film production in the state went to out-of-state workers. Similar results were found in Connecticut, Arizona, Rhode Island, and Michigan, which have all concluded that a large percentage of expenditures funded by state tax credits occur out-of-state. Tannenwald, *supra* note 11. South Carolina estimated that it recouped 19 cents on the dollar and Louisiana 16-18 cents, despite having some of the most generous incentive schemes. William Luther, *Movie Production Incentives: Blockbuster Support for Lackluster Policy*, Tax Policy Foundation, No. 173 (January 2010), available at <https://files.taxfoundation.org/legacy/docs/sr173.pdf>.

⁶³KATZ, *supra* note 1, at 70.

⁶⁴Tannenwald, *supra* note 11.

⁶⁵*Id.*

⁶⁶*Id.*

⁶⁷For example, insurance companies in Massachusetts bought up to half of the state's transferable credits through 2009 and banks in Connecticut purchased several millions' worth of credits in 2006-2007. *Id.*

⁶⁸In Massachusetts, only about 10 percent of the more than \$166 million in awarded tax credits in 2009 had been claimed by the end of that year, leaving the state with a looming liability of \$150 million. *Id.*

⁶⁹*Id.*

⁷⁰*Id.*

⁷¹Luther, *supra* note 62, at 2.

⁷²Schuyler M. Moore, *Commentary: Could Federal Tax Credit End Economic War Among States?*, HOLLYWOOD REP. (May 29, 2009, 11:19 AM), <http://www.hollywoodreporter.com/news/commentary-federal-tax-credit-economic-84707>.

⁷³Tannenwald, *supra* note 11. See also Luther, *supra* note 62; and Courtney Siders, *Legislative Updates: Independent Film and Television Production Incentive Act: Congress Attempts to Prevent Runaways*, 11 DEPAUL-LCA J. ART & ENT. L. 495, 508 (Fall 2001).

⁷⁴Tannenwald, *supra* note 11.

⁷⁵Because producers rely on skilled workers for many aspects of film production and most locations lack "crew depth," these laborers are brought in from outside the state. These out-of-state workers tend to

hold positions with the highest salary. The only local jobs created are low-wage and temporary, such as hairdressing, makeup, carpentry, catering, and moving/storage. Tannenwald, *supra* note 11.

⁷⁶Luther, *supra* note 62, at 1.

⁷⁷See Joe Barrett, *Tax Credit Fraud Puts Filmmaker in Prison*, WALL ST. J. (May 18, 2011), <https://www.wsj.com/articles/SB10001424052748704281504576329721447700398>; and Alex Ben Block, *Filmmaker Breaks Silence Over Tax-Credit Prison Nightmare*, HOLLYWOOD REP. (Feb. 27, 2014, 7:00 AM), <http://www.hollywoodreporter.com/news/filmmaker-daniel-adams-breaks-silence-683100>.

⁷⁸Joseph Henchman, *More States Abandon Film Tax Incentives as Programs' Ineffectiveness Becomes More Apparent*, TAX FOUND. (June 2, 2011), <https://taxfoundation.org/more-states-abandon-film-tax-incentives-programs-ineffectiveness-becomes-more-apparent>.

⁷⁹See Wicker, *supra* note 2, at 490; Siders, *supra* note 73, at 496; Wright, *supra* note 29, at 800-01; Sahil Chaudry, *The Impact of the JOBS Act on Independent Film Finance*, 12 DEPAUL BUS. & COMM. L. J. 215, 215-16; and Shahrokh Sheik, *Fast Forward on Crowd Funding Although Donation-Based Crowdfunding has Experienced Some Success, Questions Remain About the Practicality of Equity-Based Crowdfunding*, 36 L.A. LAW. 34.

⁸⁰KATZ, *supra* note 1, at 15.

⁸¹*Id.* at 2.

⁸²*Id.* at 4.

⁸³*Id.* at 3.

⁸⁴Wright, *supra* note 29, at 739-40.

⁸⁵Battista, *supra* note 5, at 276.

⁸⁶Battista, *supra* note 5, at 267.

⁸⁷*Id.* at 498.

⁸⁸Moore, *supra* note 8, at 28.

⁸⁹See MOORE, *supra* note 9, at 73-74. For example, Schwarzenegger received bodyguard service and access to a fully equipped gym during filming of "Terminator III." McDonald, *supra* note 12, at 929-30.

⁹⁰The six majors, all represented by the Motion Picture Association of America, are Walt Disney Co., Paramount, Sony, Twentieth Century-Fox, Universal, and Warner Brothers. Our Story, MOTION PICTURE ASSOCIATION OF AMERICA, <http://www.inpaa.org/our-story> (last visited July 25, 2017). One additional layer, quite new on the scene, includes retailers who generate content for consumers with whom they have a "direct link" (e.g., Netflix, YouTube, Showtime, and even Wal-Mart) and have "bypassed studios and standard distribution channels" altogether. Moore, *supra* note 3, at 25.

⁹¹For example, Orange County, New York City, Philadelphia, and Dallas have all offered inducements to attract principal photography to their locales. See Lytton, *supra* note 7, at 725; KATZ, *supra* note 1, at 65; Wicker, *supra* note 2, at 494; and McDonald, *supra* note 12, at 947-48.

⁹²McDonald, *supra* note 12, at 901.

⁹³For example, producers will often create a business entity to hold the rights to a given film and to raise money for the production. LLC is the best entity, as it offers both protection from corporate liability for the owners and passes profits and losses through to shareholders for tax purposes. MOORE, *supra* note 9, at 40. When a foreign investor backs a film, the tax issues multiply since foreign investors in an LLC are treated differently for tax purposes. Marsha-Laine F. Dungog, *Tax Tips: Tax Issues for Foreign Investors in U.S. Films*, 32 L.A. LAW. 14, 14-16 (July/Aug. 2009).

⁹⁴M. Katharine Davidson and Mark Saulino, *The Jobs Creation Act of 2004 and the Entertainment Industry*, 28 L.A. LAW. 12 (May 2005).

⁹⁵Battista, *supra* note 5, at 284.

⁹⁶Tax competition is considered harmful when a country utilizes "any feature of its tax system to 'enhance' its competitive advantage in the marketplace for capital, investment, and/or nominal business presence." Readily available tools for such a purpose include how tax rates and the base are defined; transparency and disclosure requirements; and special exemptions, rebates, and deductions. Diane Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, 9 FLA. TAX REV. 555, 561-62 (2009).

⁹⁷Battista, *supra* note 5, at 307.

⁹⁸*Id.* at 301.

⁹⁹Siders, *supra* note 73, at 516-22.

¹⁰⁰Given its inherently temporary/project-based nature, attracting principal photography is an unlikely basis for long-term economic growth. Tannenwald, *supra* note 11.

¹⁰¹Stephanie Baker, *Why Hollywood Makes Digital Magic in the U.K.*, BLOOMBERG BNA (Sept. 9, 2016), <https://www.bloomberg.com/news/articles/2016-09-09/why-hollywood-makes-digital-magic-in-the-u-k>.

¹⁰²*Id.*

¹⁰³KATZ, *supra* note 1, at 40.

¹⁰⁴Baker, *supra* note 117.

¹⁰⁵*Id.*

¹⁰⁶Moore, *supra* note 3, at 24.

¹⁰⁷*Id.*

¹⁰⁸See Dungog, *supra* note 93, at 18.

¹⁰⁹McDonald, *supra* note 12, at 942.

¹¹⁰Luther, *supra* note 62, at 1.

¹¹¹*Id.* at 2.

¹¹²KATZ, *supra* note 1, at 68.

¹¹³Indeed, a conference of mayors have called on the federal government to do just that. Wicker, *supra* note 2, at 492.

¹¹⁴McDonald, *supra* note 12, at 905.

¹¹⁵One approach would be to consider the likely financing options available to the intended beneficiary and whether general tax policy helps or harms. Many one-off films may rely on private offerings to a small group of investors—promoters solicit funds through existing relationships but must file the applicable private offering documentation. The costs of such filing may be prohibitive, particularly when considered in light of the benefit to be received. MOORE, *supra* note 9, at 51-52. Crowdfunding is another (new and increasingly utilized) source of financing for film production. Deborah L. Jacobs, *The Trouble with Crowdfunding*, FORBES (Apr. 17, 2013), <http://www.forbes.com/sites/deborahljacobs/2013/04/17/the-trouble-with-crowdfunding/#319d500725f4>.

¹¹⁶See Litwak, *supra* note 16, at 24.

¹¹⁷Wright, *supra* note 29, at 798 (quoting Jack Kyser, chief economist for the Los Angeles Economic Development Corporation).

¹¹⁸Wicker, *supra* note 2, at 498.

¹¹⁹Luther, *supra* note 62, at 8.

¹²⁰Wicker, *supra* note 2, at 497.