CREDITS AND INCENTIVES

Money Is Where The Movie Is

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I. Introduction.

The economic incentives generated by motion picture and television (TV) productions have rapidly evolved into a critical component of domestic and international film finance and location decision-making. Currently, although there is a limited federal film incentive program available to filmmakers and investors in the United States[1], thirty-five (35) U.S. states, and Puerto Rico, offer financial incentives for producers in the form of tax credits (including both transferable and refundable credits), grants, and rebates – ranging from five percent (5%) to forty percent (40%) of qualified production costs. In addition, approximately thirty (30) countries now offer national and local incentives to nonresident producers.[2] In light of these trends and the broad availability of incentives related to such economic activity, this article will explore and shed light on the origins and importance of film incentives in key domestic jurisdictions, and provide positive guidance with respect to how these incentives might impact your organization and clients.

II. Origin Stories – Ugly Betty, Walter White and Ralph Lamb.

As a consumer of media and popular culture, you may well recognize the character names of Ugly Betty (of the eponymous ABC series), Walter White (of AMC's critically acclaimed *Breaking Bad*), and Ralph Lamb (the principal role in CBS's *Vegas*). But beyond their place in the public mind as iconic TV characters, they are each, in their own way, representative of the fluid nature of film incentives in the modern production dynamic because the decision-making behind where to shoot each of their respective

1 IRC Sec. 181 provides an immediate tax deduction of the first $15 million of film costs for qualified film and TV productions commencing after December 31, 2007, and before January 1, 2017.

2 Chianese, Joseph and Marman "Marco" Cordova, *The Guide: An Essential Resource for Global Production Incentives,* Los Angeles, Entertainment Partners, 2014. Print.

Continued on page 8

series inspired lawmakers in multiple states to create or expand film incentive programs.

The decision by ABC Studios to relocate the production of *Ugly Betty, Season 3* from Los Angeles to New York City led to the creation of California's so-called "Ugly Betty Bill" (SB X3 14), as signed into law by Governor Arnold Schwarzenegger on February 19, 2009. This statute, provided California for the first time with a film tax credit program, worth twenty percent (20%) to twenty-five percent (25%) of "below-the-line" (e.g., compensation to crew members, excluding payments to "above the line" workers - producers, writers, directors, actors, etc.) and other qualified production costs (e.g., payments to local vendors for equipment and services), to help curb runaway productions from shooting pilots and TV series in destinations outside California. Ironically, insofar as the bill's drafters created a tax credit to attract motion pictures, new TV series originally distributed through basic cable, and movies of the week or miniseries, only *relocating* TV series "that filmed all of its prior season or seasons outside California"[3] were technically eligible to receive the credit. Thus, *Ugly Betty* itself was never able to actually utilize the California incentive program it helped inspire.

Similarly, in New Mexico (the filming and narrative location of *Breaking Bad*), HB 379 was signed into law by Governor Susana Martinez in 2013, shortly after Sony Pictures Television wrapped production of its final season of *Breaking Bad* and its protagonist, Walter White. This so called "Breaking Bad Bill" has served to enhance New Mexico's preexisting film tax credit program by providing certain TV series an additional five percent (5%) tax credit, for a maximum of thirty percent (30%) on some or all direct production expenditures. *Breaking Bad* employed two hundred (200) production workers on average during the show's six (6) year run; and, due to its tremendous ratings and critical acclaim, the series also placed Albuquerque on the map as a popular tourist destination.[4] The additional 5% bonus for TV series led to an increase in the volume of large TV projects shot in New Mexico from six during fiscal years 2013 and 2014 to ten during fiscal year 2015.[5]

In addition, and as evidence of the clear cause-and-effect dynamic created by such incentive programs, New Mexico's film incentive also prompted CBS Television to shoot most of principal photography for the TV series, *Vegas*, in Santa Fe, New Mexico, rather than in the series' narrative home of Las Vegas, Nevada. *Vegas* aired for two seasons and featured the life of former Clark County Sheriff Ralph Lamb, who was credited for cleaning up Las Vegas during the historical period in which the city was still under the practical control of mobsters. The producer's decision to shoot primarily in New Mexico highlighted for Nevada lawmakers the exodus of entertainment related jobs and businesses due to a lack of film incentives.[6] And in response, this insight led to the subsequent introduction of SB 165, which allowed for a twelve percent (12%)[7] to fifteen percent (15%) tax credit plus bonuses against qualified expenditures of at least $500,000 for producers that incur sixty percent (60%) or more of their production costs, including pre-production and post-production, in Nevada. The bill was signed into law by Governor Brian Sandoval on June 11, 2013.

III. Contemporary Counter-Trends – A Fast-Forward to December 2015.

Although California, New Mexico, and Nevada have passed new laws to extend and/or enhance their film incentive programs in recent years,[8] at the same time, growing deficits, budget stalemates and political pressures have also led to program cuts and less favorable incentives for filmmakers in other state jurisdictions; and several states lost their film incentive programs during 2015.

- In New Jersey, lawmakers allowed its film tax credit to expire with taxable years commencing after July 1, 2015.[9]
- Moreover, in Michigan, HB 4122 was approved by Governor Rick Snyder and became Public Act 117 of 2015, effective July 10, 2015. This statute eliminated Michigan's film incentive program, although it kept the Michigan Film Office intact.
- Similarly, Alaska's film tax credit was repealed effective July 1, 2015.[10] In his related signing

3 Cal. Rev. & Tax. Code §23685 (b)(22).

4 Martin, Claire. "Breaking Up With 'Breaking Bad' is Hard for Albuquerque." The New York Times 29 Sep 2013: n.pg. Web.

5 New Mexico Film Office. Statistics. Web. 11 Dec 2015.

6 Fantasia, Patty. "Nevada Passes Film Incentives!" Examiner 24 June 2013: n. pg. Web.

7 Reduced to 10% in 2016 and 8% in 2017.

8 California expanded and extended its film tax credit program for another five years in 2014 through the passage of AB 1839. New Mexico enhanced its tax credits through extending the state's existing 30% tax credit for TV series to stand-alone pilots and HB 216 allowed a film production company to assign its film tax credit to a third-party financial institution to encourage more independent film production. Nevada Governor Sandoval approved SB 94 on May 27, 2015. The bill removes the $10M cap over the four years of the program and also converts the tax credits from an expiring pilot program to a permanent program.

9 N.J. Stat. § 54:10A-5.39

10 Alaska SB 39, signed into law 6/15/2015, Chapter 35 SLA 15

Continued on page 9

statement, Governor Bill Walker indicated that "we are facing unprecedented financial times. As we prepare to lay off troopers and close at least two trooper stations, it is difficult to justify continuing this program. The film tax credit program is already set to sunset in 2018 and we just don't see oil prices bouncing back before then. [11]"

Meanwhile, although lawmakers from some other key production states kept their film incentives intact, state budget stalemates nevertheless resulted in uncertainty for several prominent film incentive programs during 2015. Pennsylvania historically allocates $60 million towards its film incentive program per fiscal year, but due to a budget impasse, the state lost production work during 2015.[12] Similarly, the Illinois state budget, also at an impasse, resulted in the deferral of initial Film Tax Credit Approvals for tax credit eligibility on June 2, 2015. However, Illinois Governor Bruce Rauner recently announced that the film office would resume approvals of Accredited Production Certificates on November 10, 2015.[13] The Illinois Film Office has further clarified that the issuance of the Certificate does not require appropriation authorization, but obligates the state to pay the credit if all the required terms and conditions of the credit are met by the production.

IV. Deep Dive to Recent Changes in High Impact State Incentive Programs

With the foregoing recent developments in production-related incentives as context, it is also helpful for us to examine more closely two of the strongest and most impactful state-level domestic programs – Louisiana and Georgia, which during 2013 were both considered among the leading production jurisdictions in the world, in addition to California, Canada and the United Kingdom.[14] Unlike California, however, both Louisiana and Georgia incentivize payments for "above-the-line" non-residents, which can account for a significant portion of a production company's total budget; and the film tax credit programs of both states, therefore, stand out from other state-level film incentives due to their high impact on local economic and production activity.

A. Louisiana

In large part due to its successful film tax credit program, Louisiana has been nicknamed "Hollywood South," as the number of motion picture shoots from major and leading independent studios in that state topped other leading production states in the U.S. in 2013.[15] However, a combination of factors, such as heightened public awareness of tax credits redeemed by "tent-pole" films (e.g., *Jurassic World*) and the state's large fiscal deficit, resulted in the state's legislature passing new laws to limit the film incentive program during its 2015 session.

As a starting point, Louisiana provides a base thirty percent (30%) partially-refundable tax credit (the state will buy-back a dollar's worth of tax credits for eighty-five cents) as well as a fully-transferable income tax credit. During the 2015 legislative session, however, numerous changes to the program were enacted, including increasing the bonus for hiring Louisiana residents from five percent (5%) to ten percent (10%). Most impactful, the Legislature initiated an annual $180M claim cap for fiscal years 2015-2016, 2016-2017 and 2017-2018 on credits claimed by any taxpayer. The claim cap applies to all taxpayers, including production companies electing the partial refund[16] or claiming the credits on its tax returns, as well as corporate and individual taxpayers who purchase these credits at a discount to offset their tax liabilities. Note, however, that the cap also injects uncertainty for transferees of tax credits because it is possible for the state to issue more tax credit certificates during the affected fiscal years than the $180 million claim cap – although it is expected this issue with the program will likely be re-examined during the Louisiana Legislature's special session in February 2016. Additional changes to the program affecting the claiming of the credit include the following: (i) the tax credit is now considered earned during the taxable period when a production receives final certification, as opposed to the year of the production spend; and (ii) the carry-forward period for a tax credit is now five (5) years instead of ten (10).[17]

Procedurally, upon completion of Louisiana

Continued on page 10

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11 The State of Alaska. "Governor Signs Bill Ending Tax Credits." Web. 16 June 2015.

12 Blumgart, Jake. "Films shot in Philadelphia fade to black amid state budget standoff." Philly Voice. 23 Nov 2015: n. pg. Web.

13 Illinois Department of Commerce. "Administration Takes Step Forward on Job Creation Tax Credits." Web. 10 Nov 2015.

14 FilmLA. 2013 Feature Film Production Report. Web.

15 FilmLA. 2013 Feature Film Production Report. Web.

16 Louisiana suspended the state buy-back of tax credits for fiscal year 2015-2016

17 Louisiana HB 829, 6/19/2015 Signed by the Governor - Act 134

production activity, a final certification request for the tax credit is made. For final certification requests made on or before December 31, 2015, a production may engage a CPA firm of its choice and submit an audit with its request. However, a couple of high-profile cases that uncovered audit deficiencies[18] produced rule changes (effective December 31, 2015) in which the Louisiana Film Office now will directly engage and assign a CPA to prepare the production expenditure verification report for Final Certification.[19] In addition, Louisiana's 2013 Act No. 418 authorized the Department of Revenue to implement a Tax Credit Registry to record the use and transfer of various Louisiana tax credits, including the film tax credit. This law provides recapture provisions applicable against any party, with the notable exception that "a good faith transferee, as determined by the department at the time of transfer who relied on the validity of the credits recorded in the registry" shall not be subject to the otherwise appertaining recapture provisions.

B. Georgia

Similar to Louisiana, Georgia provides for a thirty percent (30%) transferable tax credit on production – twenty percent (20%) of this credit is the base amount, and the additional ten percent (10%) uplift is awarded for including the required Georgia promotional logo or an end-title credit.[20] In 2015, the recent limitations and changes to the Louisiana tax credit program resulted in even more production activity flowing to Georgia, and Governor Nathan Deal announced that "film and television productions generated an economic impact of more than $6 [B]illion during fiscal year 2015 (July 1, 2014 - June 30, 2015). The 248 film and television productions shot in Georgia represent $1.7 [B]illion in spending in the state."[21]

Consequently, due to the large supply of Georgia film tax credits, they are considered one of the more readily available transferable tax credits in the U.S. An important consideration for corporate and individual income taxpayers who buy these credits is that, on January 1, 2012, the Georgia Department of Revenue (DOR) initiated a voluntary program for Film Tax Credit Verification. The program provides production companies the opportunity to verify costs that are eligible for the credit, and the DOR "shall be bound by the findings of this Film Tax Credit audit, even if the Department subsequently performs an audit for non-Film Tax Credit reasons."[22] Prior to the DOR verification program, production companies provided purchasers of their Georgia film tax credits either CPA audit or review reports of the qualified production costs to quantify the tax credit. However, any Georgia film tax credits claimed on tax returns relying on such audit or review reports are still subject to post-audits and therefore, devaluation. Despite this, many production companies are still opting for the CPA audit or review report option instead of the DOR voluntary audit program due to the costs of the Georgia DOR Film Tax Credit Verification, and the industry also considers the CPA report route to be more expeditious than the DOR voluntary audit option.

Yet, despite this perception, there are two primary reasons buyers of Georgia film tax credits should purchase only credits verified by the DOR. First, the DOR hired new auditors during the fourth quarter of 2015 to focus on post-audits of film credits claimed on tax returns that did not go through the DOR voluntary audit program during the past two years – suggesting an enhanced forthcoming enforcement effort. Second, the ten percent (10%) uplift is based on the inclusion of a Georgia Entertainment Promotion's (GEP) "Peach Logo" during the end-title credits of the qualified movie or TV production. And in this regard, the GEP Application provides that "[t]he GEP tax credit uplift will be allowed for projects which the Georgia Department of Economic Development has determined will create valuable promotions that will enhance the State's brand."[23] So, what happens if a production company initially receives an approved GEP application certificate, but cannot find distribution for its film

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18 Russell, Gordon. "Bad timing: Scandals, criticism erupt around Louisiana's film credit program." The New Orleans Advocate. 28 February 2015: n.pg. Web.

19 See HB 604 (Act 412)

20 Ga. Code. Ann. §48-7-40.26

21 The State of Georgia. "Deal: Film industry generates $6 billion for Georgia's economy." Web. 9 July 2015.

22 State of Georgia. Department of Revenue. Web. 11 Dec 2015.

23 State of Georgia. Entertainment. Web. 11 Dec 2015.

Continued on page 11

in any theater, TV, or cable network? To the extent that the Georgia film tax credit was calculated through a CPA audit or review, then it is possible that the DOR may devalue ten percent (10%) of the entire thirty percent (30%) tax credit if the film or TV project did not promote "The Peach State" as intended.

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V. Final Thoughts.

Film incentives are a unique and increasingly important way for production companies, investors and, in some cases taxpayers not affiliated with the entertainment industry, to benefit financially. Meanwhile, various jurisdictions hope to fulfill economic and policy goals through such incentive programs. However, producers must tread lightly when selecting a location to shoot primarily for financial incentives because economic, political, and policy changes are as unpredictable as having your favorite TV show ruined due to a new storyline or cancelled next season. Producers must also consider available funding, tax credit utilization, recapture risk, exchange rates (for foreign film incentives), qualified costs and incremental costs when selecting a location or multiple jurisdictions for film incentives. In summary, filmmakers are constantly in search of that next big incentive break and hopefully keep viewers like you entertained.

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Marco Cordova, CPA, MST, has over 20 years of progressive tax experience, specializing in federal, foreign, and state tax credits, and various credits & incentives programs. He worked in large public accounting firms, as well as publicly traded and private companies in senior and executive tax management roles. Marco has extensive experience with the placement, monetization, and syndication of transferable and investment tax credits, with a focus on film incentives, and other tax credits, including federal and state renewable energy, historic, and low income housing. Marco previously represented Sony Pictures on the state and local tax and film incentive committees with the MPAA, and was the co-editor of widely distributed foreign and domestic production incentive publications for the entertainment industry.

Currently, Marco is a member and actively involved with several tax associations, including the AICPA and IPT, and he serves on the Loyola Marymount University Accounting Advisory Board. Marco is regularly invited to speak in conferences and lectures throughout the U.S. about tax credits and incentives, and has been quoted on several news articles about various tax credit programs.