



## **Seduction: The Disaster Story of Iowa's Film Tax Credit**

### **Act One: Introduction and Overview**

Everyone likes a good show.

Does that mean Iowa taxpayers should foot up to half the bill for the production of movies and films, just because they were shot in Iowa? That's the law today, but it has been under increasing criticism due to alleged abuses and misuse.

Fiscal policy issues raised by the film credit program should be of as much concern to state lawmakers and their constituents as the very serious management issues that have resulted in a state investigation of the program. All the issues surrounding the credit should be addressed before lawmakers decide whether to reinstate any form of a film development incentive.

Even if the management of the credit is tightened, the costs to taxpayers may run to \$70 million or more per year by 2014, according to the Iowa Department of Revenue. For 2011 alone, the loss could be \$50 million when lawmakers seek to put together the next state budget, at the same time the Legislative Services Agency projected a budget deficit of \$900 million that needs to be filled. As Iowa is facing its worst financial crisis since the depression, the state could be on the hook to pay out more than \$100 million in credits from contracts approved even before the start of this fiscal year.

Currently, Iowa promotes "half-priced filmmaking" with a tax credit for film production to attract filmmakers to Iowa or support Iowans who make films. As advertised, the credit allows filmmakers to get back up to one-half of what they spend. The return takes the form of state income tax credits. These credits are transferable, which means that for whatever amount they don't owe in state income tax, they can sell the remaining credit to others who do.

Therefore, a movie with a \$10 million budget could be eligible for \$5 million in state tax credits. This is a huge credit for an industry that is already well-established in the United States and certainly does not need economic subsidies to survive. The economic argument being made by promoters is that the subsidy will induce filmmakers to make films in Iowa rather than in another state. At best, this form of smokestack (or shutter) chasing activity benefits one state at the expense of another. Amidst an aggressive campaign by the film industry to seek such tax credits, over 30 states have enacted film tax credits, with Iowa's now being among the largest in the country.

Proponents contend that a movie filmed in Iowa produces jobs and economic activity — through the hiring of actors and extras, and rentals of hotel rooms and filming locations. Since few movies have

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been filmed in Iowa prior to the tax credit, any filming that occurs in Iowa is generally attributed to the credit. Lawmakers in Iowa, as well as in many other states in the country, have enacted film tax credits based upon an argument that providing a credit results in a net gain in economic activity in the state. Since it is provided as a credit through the tax code, people also may mistakenly assume that it primarily eliminates an income tax obligation from the profits of that filmmaking, and therefore doesn't cost the state revenue. This, however, is simply false.

The arguments for providing a credit are flawed in several ways:

- Benefits vs. costs
- Benefits vs. other opportunities
- Whether benefits and costs are clear to taxpayers

First, the benefits of the tax credit need to be assessed in relation to their costs. Economists often seek to determine the “return on investment” of any economic development activity. Direct returns on the film investment would include increased sales tax revenue from the purchase of goods and services in the state, increased Iowa income tax revenues from the salaries paid to Iowa taxpayers, and the profits made by the corporation doing the filming that accrue to Iowa. Indirect returns to the economy include the “multiplier effects” as this money turns over in the local and state economy.

Second, the benefits of the tax credit need to be assessed in relation to other uses of those funds. The state budget is based upon balancing state revenues (primarily taxes) with state appropriations (primarily expenditures on education, health and human services, and public safety). A tax credit to the film industry is a budget expenditure that otherwise could be used to make investments in education, work and training programs, child care, or other economic development activities. A film tax credit also could be used to reduce taxes to the public generally, such as increasing the state earned income tax credit or lowering property tax rates for Iowa consumers whose purchases help to stimulate the economy. At a minimum, the relative economic impact of a film tax credit needs to be compared with economic impacts of alternative uses of these funds. In addition, the public value of the film credit vs. other uses of the funds needs to be examined. While everyone enjoys a good show,, supporting the film industry is not an essential government function, although providing education, health and human services, and public safety do meet that test.

Third, the selection of a tax credit rather than a direct appropriation needs to be assessed for its efficiency, transparency and accountability. Once established, tax credits are not subject to the same required annual scrutiny as state appropriations of funds nor are individual projects subject to any review as to their specific value or public purpose, as are appropriations in the form of state grants or program expenditures. Even if Iowa decides there is merit in making an investment to secure filming in Iowa, lawmakers need to determine the most efficient and accountable way to do so and not assume that a transferable tax credit is the best means.

## **Act Two: The History and Operation of Iowa's Film Tax Credit**

Iowa's film tax credit was first enacted in 2007, as part of a concerted national effort by the film industry to promote state tax credits for film production. To qualify, individuals and businesses must establish a taxable nexus in Iowa. Credits are awarded to entities responsible for the project and not to the individuals directly. The initial legislation had substantial restrictions on the expenditures that would be eligible for coverage under the credit and had a very low projected cost to the state. One provision of that law, however, allowed the sale of unused credits to other taxpayers, expanding their application outside the intended use by the film industry, and raising costs.

In 2009, lawmakers expanded Iowa's film tax credit substantially and eliminated or modified many of the restrictions. The 2009 legislation (SF480) expanded the tax credit to include expenditures that were excluded under the previous law. The salaries for directors, producers and principal cast members were now a covered expenditure for up to \$250,000 (for projects over \$10 million) and \$1 million (for projects over \$20 million.) The effective size of the credit increased dramatically. With the 2009 legislation, the Iowa had become one of the most generous credits of any state offering a film tax credit.

The cost of the film tax credit is the amount of state revenue lost, less any increase in tax revenues that result from the film activity. According to the Department of Economic Development's project status list as of September 17, 2009, the Department has awarded \$64.9 million in film tax credits. It also had approved another 109 film credit applications with an estimated value of \$504.8 million, although not all those films will go into production. It also has 26 projects under contract, with an estimated value of \$156.2 million, bringing the total to \$725.9 million.

Data on the credit are just starting to come in. In its Tax Credits Contingent Liabilities Report of August 14, 2009, the Iowa Department of Revenue reports the Iowa film tax credit cost the state \$3.6 million in SFY2009, for filming before the changes in the law in 2009. It forecast that the credit will cost the state \$77.4 million in SFY2010, and \$78.8 million in SFY2011.

The Department of Economic Development has established a tentative "cap" on the amount of film credits in 2010 of \$50 million, because the General Assembly established an overall cap of \$185 million on four large tax credits. It is not expected that the other three credits will cost \$130 million in 2010, however, so the current "cap" on film credits may be revised upward.

In recent weeks, concern has grown over inadequate oversight of the film tax credit and certain expenditures under the film tax credit that should not have been allowed. These issues are important, but the larger issue of the size and appropriateness of Iowa's film tax credit needs to be examined carefully.

### **Act Three: Losing Arguments on the Benefits of the Film Tax Credit**

The film industry is expert in marketing and selling dreams and fantasies. Advocates for the film tax credit have pointed to the sudden influx of filming into Iowa and signs of a developing Iowa film industry as a reason for its continuation. There is little doubt that Iowa's credit has produced a large share of this influx, but the question is whether the value of having films shot in Iowa warrants their cost.

Iowa is not alone in establishing a film tax credit; many states have established these credits at the urging of proponents of the film industry. The size of the credits has steadily increased over time, as advocates have argued that each new state must be competitive and exceed the credits available elsewhere. Since filmmakers, unlike permanent businesses, often can move locations easily, the state with the greatest benefits is likely to get a good deal of business, but at a huge cost. It's a losing proposition, and the higher the credit, the greater the loss.

#### ***Losing argument No. 1 — Iowa revenue will expand as a result of film activity.***

One argument that has been made is that the increased economic activity produces new revenue for the state — in terms of direct taxes paid by actors and workers on the films, sales and hotel tax revenues from goods and services purchased in the state, and corporate income taxes from films that are successful at the box office.

The Wisconsin Department of Commerce studied its own state's film tax credit and concluded it was a big losing proposition for the state. For the film *Public Enemies*, the agency determined that the

increased revenue to the state from the production activity was only 6 percent of the cost to the state, a net negative return on investment of 94 cents for every dollar invested. Further, a significant share of the qualified expenditures actually were for goods and service purchased outside the state, and a large share of the salaries were to workers or actors who came into the state for the production, and then left.

Wisconsin has subsequently severely curtailed its film tax credit.

It should be noted that, even if a film is extremely profitable, Iowa would receive almost no tax revenue as a result of that profitability. Since Iowa is a single-factor corporate income tax state, the film company will not pay taxes on profits because it was filmed in Iowa, but only on the profits that were made from sales of tickets in Iowa. If a film that cost \$50 million to make had worldwide sales of \$150 million and a profit of \$100 million, its likely profit in Iowa subject to Iowa taxation would be less than \$1 million. While Iowa would have invested half the cost of making the film, it would receive tax benefits on less than 1 percent of the profits. In reality, filmmakers will pay virtually no taxes in Iowa, so the tax credit really represents a subsidy, like a direct payment or appropriation.

In short, there is very little economic return to the state from such film investments. The more that the tax credit is used, the greater the costs to the state.

***Losing argument No. 2: Iowa employment and economic activity will increase as a result of the film tax credit.***

The primary argument for the film tax credit has been that it will produce jobs for Iowans, but the state costs that are associated with the film credit need to be examined compared with alternative uses for those funds.

In the case of the film credit, the jobs that are created last only as long as the film is being produced. Most economic development incentives are designed to produce job growth that continues after the initial credit. Moreover, some of the jobs do not even go to Iowans, although they may be required to pay Iowa taxes on the income they earn when in the state. This applies to national actors and producers, but it also may apply to some of the filming crew. These are two major limitations on the actual value of the credit to Iowans.

The Wisconsin Department of Commerce also compared the cost per job created through its film credit with other economic development programs and found that the costs per job created were at least 20 times higher than for other programs and were temporary jobs, where many of the other programs produced permanent jobs.

The “multiplier effect” of dollars spent for film production activity is likely to be quite low and the number of jobs created minimal and very short-term. If an equal amount were instead pumped into improving Iowa’s child care system, the impact on Iowa employment and income would be larger, while also providing direct help to more Iowans.

Fifty million dollars in tax subsidies to the film industry equates to 879 classroom teachers in Iowa at average pay and benefits. Iowa currently is facing a budget crisis that could result in reductions to state spending on education that would require very significant education layoffs. This would affect the quality of Iowa’s educational system, but it also would affect Iowa’s employment picture and workforce.

The simple fact is that the size of the subsidy is way out of proportion with its benefit. If Iowa were to enact a tax subsidy that equated to half the costs for an industry with greater benefit to the state — such as wind energy — Iowa doubtless would become a mecca for the production of wind generators. Most

Iowans believe that this would serve a greater long-term public purpose than supporting film-making, but it also would literally bankrupt the state with its costs.

***Losing argument No. 3: Tax credits, and transferable tax credits in particular, are a good way to make economic development investments.***

Trying to stimulate economic activity through the tax code and through refundable or transferable tax credits, in particular, is dangerous. Tax credits in Iowa have not been subject to the same scrutiny as direct appropriations. Once on the books, they do not have to meet annual legislative and executive branch review, as direct appropriations. Even if they are designed for a particular purpose, they often can be manipulated to be used for broader or unintended purposes, through creative efforts by accountants and attorneys to maximize tax benefits. They can become open-ended, or near open-ended, drains on the treasury. This is clear by the simple fact that the cost of the film tax credit was never considered to be of the size it has turned out to be. Fiscal notes prepared at the time of the legislation showed relatively minor impacts from the credits, but they have ballooned in size.

The transferability of the credit to other taxpayers is a key culprit in this respect. It really turns a tax break into a subsidy, as filmmakers “sell” these tax credits to Iowans who do owe income taxes. Moreover, they generally sell them at some discount, and often through brokers who claim a share of the credit for arranging the transactions. To add insult to injury, the filmmakers then consider the broker fees they pay as a cost of doing business, so the state pays half of those broker costs. A transferable credit is even less efficient than a refundable credit, costing the state more in costs and providing less benefit to the intended recipient.

If Iowa is going to subsidize the film industry, a more transparent and accountable way would be provide such a subsidy directly through a grant or forgivable loan, rather than through the tax code, potentially one where Iowa also received a fair share of the profits from its investment. This also would put Iowa economic development investments in film production on the same ground as other Iowa economic development investment funds administered through the Iowa Department of Economic Development. Alternatively, an expansion of funding to the Iowa Arts Council or the University of Iowa Writers Workshop could provide an opportunity to support creative Iowans across a broad range of the arts.

## **Act Four: Conclusion**

Iowa is not alone among states in being taken in by the filmmaking industry, but other states are recognizing that the benefits do not match their costs. Iowa needs to critically review its film tax credit and assess it against other uses of the funding.

Both progressive and conservative groups have called into question the film tax credit in other states. It is time for Iowa to examine all its tax credits for their merit, but given the explosion of the film tax credit and its potential consequences to the state budget, it should be at the top of the list.

## **Iowa Fiscal Partnership**

*The Iowa Fiscal Partnership is a joint fiscal policy initiative of two nonprofit, nonpartisan Iowa-based organizations, the Child & Family Policy Center in Des Moines and the Iowa Policy Project in Iowa City. IFP reports are available at [www.iowafiscal.org](http://www.iowafiscal.org).*