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Senate Bill 1535 (Substitute S-1 as reported)
Sponsor: Senator Tom George
Committee: Finance

Date Completed: 11-5-08

RATIONALE

A package of legislation enacted in the spring of 2008 offers filmmakers a variety of tax credits in order to encourage them to make movies, television shows, and other film and digital media productions in Michigan. These measures include Public Act 77 of 2008, which amended the Michigan Business Tax (MBT) Act to permit an eligible production company to claim a credit against the MBT or the income tax if the company has entered into an agreement with the Michigan Film Office; spent at least \$50,000 in Michigan for the development and production costs of a State-certified qualified production; and received a postproduction certificate of completion from the Film Office. The agreement may allow a company to claim a tax credit equal to 40% of direct production expenditures, or 42% if the production is in a core community, and 30% of qualified personnel expenditures. As of early September, \$148.8 million in credits had been approved for various film projects. If all of these projects were carried out, it is estimated that they would generate approximately \$26.6 million in new income and sales tax revenue, resulting in a net loss of \$122.2 million in State revenue. In light of the current economic climate in Michigan, it has been suggested that the amount of production credits that filmmakers may claim in a year should be limited.

CONTENT

The bill would amend the Michigan Business Tax Act to set an annual limit of \$50.0 million on the total amount of credits claimed by film companies

issued postproduction certificates of completion.

Specifically, the bill would require the Michigan Film Office, with the concurrence of the State Treasurer, to enter into a limited number of agreements during each calendar year. For the 2008 calendar year and each subsequent calendar year, the total of all credits for all postproduction certificates of completion issued during the calendar year could not exceed \$50.0 million.

Currently, the Office must process a request for a postproduction certificate within 60 days after the request is complete. Under the bill, if the total amount of all credits for which postproduction certificates of completion were requested in a single tax year exceeded \$50.0 million, the Office would not have to process those requests and issue those postproduction certificates of completion that exceeded \$50.0 million until the first day of the next tax year.

MCL 208.1455

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Michigan simply cannot afford the film production credit that was enacted earlier this year. The credit will place a tremendous burden on the State budget when it is claimed. This is because the MBT credit not only is extremely generous but

also is refundable. That is, if a filmmaker's credit exceeds the company's MBT liability for a tax year, or if the company has no MBT liability, the Department of Treasury must write it a check for the excess or for the full amount of the credit. That money will come from the State's General Fund. As a result, taxpayer-funded programs will have to be reduced unless the State generates other revenue.

Also, in addition to being refundable, this credit is assignable, which means that a filmmaker that is granted a credit may transfer it to another business that has MBT liability, in exchange for up-front funding. Thus, even if the credit were not refundable, the cost to the State would be the same. Furthermore, taxpayers that "buy" credits typically pay from 80% to 95% of their value, but claim the full amount of the credits. Therefore, the State loses 100% of the MBT revenue, while the filmmaker receives a reduced sum to fund its productions.

Paying for this credit comes at a time that Michigan's unemployment rate is the highest or almost the highest in the nation, the auto industry is drastically downsizing, and more job losses are on the horizon. Meanwhile, Michigan-based small and medium-sized businesses continue to pay their full business taxes, including a new surcharge, while many of them are struggling to survive.

By setting a cap of \$50.0 million on the amount of the film production credit that may be taken in a year, the bill would significantly limit the potential cost of the credit to the State in future years. A generous credit still would be available to encourage filmmakers to produce movies and TV shows in Michigan, and the credit still would be refundable. In addition, the other incentives enacted last spring—including an MBT credit for job training expenditures, the free use of public property, loan programs, and an MBT credit for investment in a film and digital media infrastructure project—would remain in place.

Response: The production credit is unlikely to be as expensive as predicted. Although \$151.3 credits had been approved as of early October, \$30.4 million of those credits were for projects that already have been cancelled or relocated. To date, no

postproduction certificates of completion have been granted and the Michigan Film Office is in the process of evaluating the first one. The Film Office estimates that \$20.0 million to \$25.0 million in credits actually might be claimed for 2008, which is considerably less than the amount of credits approved.

Opposing Argument

Capping the film production credit would be unwise and premature. The film incentive package, including the production credit, generated immediate interest from filmmakers and has the potential to create numerous jobs in a relatively recession-proof industry. A considerable amount of production activity already has taken place and some projects have even wrapped up filming. For the \$148.0 million in credits approved by early September, it is estimated that the filmmaking will generate \$394.0 million in spending. This already is beginning to occur. In the first four months after the incentive package was enacted, for example, at least 21,800 room nights worth \$2.4 million had been booked at Detroit-area hotels, and it was estimated that another \$850,000 may be collected through dining, room service, and other expenses payable to the hotels before the conventional film season ends in early November, according to an article in *Crain's Detroit Business* ("Film crews filling area hotel scene", 8-18-08).

Another example of economic activity is the construction of new sound stages. In August, it was announced that facilities would be built in southwestern Michigan, Ann Arbor, and the Grand Rapids-Grand Haven area. A new sound stage has been proposed for Lansing, as well. These state-of-the-art facilities not only will attract filmmakers but also revitalize brownfield property and provide educational opportunities, internships, and hands-on experience. Limiting the credit, however, could terminate these plans.

The incentive package also produces economic activity and jobs in the form of advertising, catering, equipment and vehicle rental, set design and construction, and tourism. In addition, banks and insurance providers have ramped up their business development activities to target the production industry, and are starting to see the benefits of doing so.

The existing credit should be left in place at least long enough for the State to realize the desired effects.

Response: Despite the level of overall economic activity generated, the production credit does not pay for itself in terms of the amount the State reimburses to filmmakers versus the amount of revenue it receives. While the private sector economy might be positively affected, the money to pay for this is coming from the State's coffers. In addition, the economic activity from film production is highly localized, while the cost of the credit affects the budget for the entire State. If the State is going to spend millions of dollars in tax credits or otherwise, perhaps it would be wiser to support education, high technology, alternative energy, or manufacturing—which could generate more widespread and less fleeting benefits to Michigan residents and businesses.

Opposing Argument

Limiting the production credit would discourage film companies from coming to this State. Although the bill would cap the total amount of credits that may be claimed in a year, rather than the total amount of credits that may be approved, this would create a very cyclical industry in which activity would fall flat once the cap was met, making it impossible for film workers to maintain consistent work.

Rather than filming in Michigan and taking a risk that claiming the credit would have to be postponed, it is likely that filmmakers would take their business elsewhere. A recent article in *Variety* quotes the president of the Association of Film Commissioners International as saying, "Incentives are the most powerful driver on the decision of the location of the film shoot" ("States vie over tax relief", 10-17-08). The tax incentives were enacted to help Michigan compete with other states that offer credits, including Louisiana, Massachusetts, and New Mexico. Capping the credit would make Michigan less competitive.

Response: Other states that enacted film credits also are reining them in, according to an article in *The New York Times* ("States' Film Production Incentives Cause Jitters", 10-12-08).

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would increase General Fund revenue by an unknown and potentially significant amount. The May 2008 Consensus Revenue Estimating Conference forecasted that certificates issued and claimed for credits during FY 2008-09 would total \$118.2 million. Assuming that estimate is correct and overlooking the timing differences between calendar year certificate approvals and fiscal year tax credit claims, the bill would increase FY 2008-09 revenue by approximately \$68.2 million. The most recent information indicates that projects totaling a potential of \$148.8 million in credits have already been approved this year, suggesting the bill could increase revenue by approximately \$98.8 million.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.