Independent Film and Television Production Incentive Act: Congress Attempts to Prevent Runaways

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LEGISLATIVE UPDATES

INDEPENDENT FILM AND TELEVISION PRODUCTION INCENTIVE ACT: CONGRESS ATTEMPTS TO PREVENT RUNAWAYS

PROPOSED LEGISLATION S. 1278
United States Independent Film and Television Production Incentive Act of 2001

OFFICIAL TITLE
A bill to amend the internal revenue code of 1986 to allow a United States independent film and television production wage credit.

I. INTRODUCTION

Runaway film and television production is a major dilemma in the United States. Over 10 billion dollars have been lost because of runaway production in the last decade. The dilemma extends beyond money lost, and into the loss of jobs. Over 270,000 jobs in the U.S. are directly involved in film production. 70 to 80 percent of these jobs are created at the location where the film or television show is filmed. Out of 308 U.S. developed television

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2 Id.
4 Id.
5 Id.
6 Dep't. of Commerce Report, supra note 3 at 1.
movies produced in 1998, 139 were produced abroad, compared to only 30 produced abroad in 1990. This is an obvious problem in the United States that has gotten more devastating in the last few years.

There are several supporters of a proposed tax wage credit for independent film production. These supporters include the non-exhaustive list of the Academy of Television Arts and Sciences, the American Film Marketing Association, the Association of Independent Commercial Producers, the Directors Guild of America, Film US, the Screen Actors Guild, the U.S. Conference of Mayors and many other guilds, organizations and small businesses. Currently, there is pending legislation in Congress concerning this proposed tax wage credit. If passed, the legislation will allow for a tax wage credit for independent film producers, with the exception of producers making films with pornographic content, for up to 25% of the first $25,000 of each employee involved in the production of the film. This is a dollar for dollar credit that can be written off by the film production company. There is a minimum wage total of $200,000 and a cap of ten million dollars on the applicable credit. There is also an exception written in the proposed bill for up to 35% of the first $25,000 of each employee when the production occurs in a low-income community. The legislation is intended to draw film production back into the United States. Hypothetically, if this happens, and film production is lured back into the United States, it will mean a montage of job openings and large economic growth in the United States, both of which have been diminished recently.

8 Dep't. of Commerce Report, supra note 3 at 1.
9 Id. at 9.
11 Television Production Incentive Act, supra note 1.
12 Id.
13 Id.
14 Id.
15 147 CONG. REC. S8476, supra note 7, (statement of Sen. Lincoln).
because of runaway production.\textsuperscript{16} It could mean a gain of several billions of dollars that have been shown, through several studies, to be lost from the United States economy because of runaway production in the last decade.\textsuperscript{17} This sounds very extraordinary, doesn’t it? The downfall is that none of this economic gain can occur unless congress passes this bill.\textsuperscript{18}

This article will portray support of this legislation, but, assuming the unfortunate, these bills do not pass in Congress the article will look to other options to try and stop this massive problem of runaway production. This article will give a background to the past and current tax code referring to business related tax credits. It will explore the history of runaway production. Finally, the article will provide an analysis of other options to resolving runaway production. This analysis largely includes the actions of other countries, which are taking away a significant part of the American economy by luring production into their own borders.

II. PROPOSED LEGISLATION

The proposed legislation would amend the internal revenue code of 1986 to allow a United States independent film and television production wage credit.\textsuperscript{19} The Senate Committee on Finance is currently reviewing the legislation.\textsuperscript{20} This bill is designed to address the problem of “runaway” film and television production.\textsuperscript{21}

Feature film and television productions have been straying overseas due to the high expenses of production in the United States, and the encouraging tax benefits and subsidies in foreign

\textsuperscript{16} Id. (statement of Sen. Lincoln).
\textsuperscript{17} The Monitor Company, \textit{The Economic Impact of U.S. Film and Television Runaway Film Production}, Screen Actors Guild and Directors Guild of America, at 3 (June 1999), at http://www.ftac.net/dga_sag_report/filmreport.html (last visited November 28, 2001) [hereinafter Monitor Report].
\textsuperscript{18} \textit{Television Production Incentive Act, supra} note 1.
\textsuperscript{19} 147 CONG. REC. S8476, \textit{supra} note 7 (statement of Sen. Lincoln).
\textsuperscript{20} Id.
\textsuperscript{21} Id.
countries for film and television production. The decrease in production has caused a massive loss for the United States economy.

The U.S. Department of Commerce estimated that this runaway production drains as much as $10 billion per year from the United States economy.\textsuperscript{24} Statistics show a major decrease in the number television movies produced in the United States in the last decade.\textsuperscript{25} Out of the 308 U.S. developed television movies produced in 1998, 139 were produced abroad, compared to only 30 produced abroad in 1990.\textsuperscript{26}

This migration of domestic film and television production has also caused a major decline in jobs.\textsuperscript{27} According to official labor statistics, more than 270,000 jobs in the U.S. are directly involved in film production.\textsuperscript{28} By industry estimates, 70 to 80 percent of these workers are hired at the location where the production is filmed.\textsuperscript{29} Runaway production affects a variety of cities and towns across the country, not just Hollywood, as most would assume.\textsuperscript{30} The scenery of the Chicago skyline, the farmland of Iowa, the lakes of Michigan, these settings and many more are used in films and television shows, and these states and cities benefit from film production within their borders also.\textsuperscript{31}

This proposed legislation is designed to encourage the producers of film and television to produce in cities and towns across the United States.\textsuperscript{32} The economic benefits of production in a country extend beyond the film and television industry.\textsuperscript{33} Other industries will benefit as well, the benefits extend to increases in jobs generated in a variety of local businesses, such as hotels,

\begin{itemize}
\item \textsuperscript{22} Id.
\item \textsuperscript{23} Id.
\item \textsuperscript{24} Dep’t. of Commerce Report, supra note 3 at 1.
\item \textsuperscript{25} Id.
\item \textsuperscript{26} Id.
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Id. at 5.
\item \textsuperscript{29} 147 CONG. REC. S8476, supra note 7 (statement of Sen. Lincoln).
\item \textsuperscript{30} Id.
\item \textsuperscript{31} Id.
\item \textsuperscript{32} Id.
\item \textsuperscript{33} Id.
\end{itemize}
CONGRESS PREVENTS RUNAWAYS

restaurants, catering companies, equipment rental facilities, and transportation vendors. The proposed tax credit is an addition to the internal revenue code section; currently this section involves business related credits. The proposed wage credit will provide a two-tiered wage tax credit, equal to 25 percent of the first $25,000 of qualified wages and salaries and 35 percent of such costs if incurred in a "low income community," for production of films, television or cable programming, mini-series, episodic television, pilots or movies of the week that are substantially produced in the United States. The credit is only available if total wage costs are more than $200,000 and less than $10 million, and the credit only

34 Id.
35 Television Production Incentive Act, supra note 1.
36 Id. infra 26 U.S.C.S. §38 Subpart D of part IV of subchapter A of chapter 1 would be amended by adding at the end of the following a new section: §45G. United States Independent Film and Television Production Wage Credit. See also 18 U.S.C. 2257: (credit is not available for film and television productions with sexually explicit conduct). The provision §45G specifically provides:

(a) AMOUNT OF CREDIT See
(1) IN GENERAL-For purposes of section 38, the United States independent film and television production wage credit determined under this section with respect to any employer for any taxable year is an amount equal to 25 percent of the qualified wages paid or incurred during such taxable year. See also
(2) HIGHER PERCENTAGE FOR PRODUCTION EMPLOYMENT IN CERTAIN AREAS-In the case of qualified employees in any qualified United States independent film and television production located in an area eligible for designation as a low-income community under section 45D or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress, See also ¶ 1 shall be applied by substituting 35 percent for 25 percent. See Television Production Incentive Act, supra note 1 infra §45G.
applies to the first $25,000 in wages, including pay for services and fringe benefits, paid to each employee.\(^\text{37}\)

Bill S. 1278, United States Independent Film and Television Production Incentive Act of 2001, was introduced in 2001.\(^\text{38}\) The sponsor of bill S. 1278, is Senator Blanche Lincoln from the state of Arkansas.\(^\text{39}\) There are thirteen co-sponsors to the bill.\(^\text{40}\)

III. LEGISLATIVE HISTORY

A. Pre-Tax Reform Act of 1976

Prior to 1976, tax benefits for investments in motion pictures existed in the United States.\(^\text{41}\) As a result, there was a considerable rise in film production in the early 1970’s.\(^\text{42}\) Before the Tax Reform Act of 1976 (hereinafter “TRA ’76”) the tax benefits received by film and television investors were through depreciation deductions and tax shelters.\(^\text{43}\) As such, it is theorized Congress did not intend to give film producers these tax benefits.\(^\text{44}\)

The benefits for film and television were not written into the internal revenue code; rather, taxpayers relied on standards from other industries, such as real estate, to achieve tax deferrals for

\(^{37}\) Television Production Incentive Act, supra note 1, infra proposed amendment to §45G.

\(^{38}\) Id.

\(^{39}\) Id.


\(^{42}\) Id.

\(^{43}\) Miles Mogulescu, supra note 41 at 841. See also p. 856 (referring to “tax shelters”).

\(^{44}\) Id. at 852.
motion picture investments. The tax benefit devices available for film investment at that time, however, were not especially efficient, and taxpayers often abused them.

B. Tax Reform Act of 1976

In the mid-seventies, TRA '76 was introduced. Unfortunately, TRA '76 did not reform the tax benefit devices to make them more proficient and effective, rather, it eliminated them entirely. TRA '76 brought about "a significant decrease in the level of film production, particularly independent production, further concentration of economic and cultural power in a handful of corporations, and a decrease in the range of cultural choices available to the public." This started the ripple effect, still existing today, in the decrease of film production in the United States.

When TRA '76 was adopted, the major tax incentives were eliminated because of the addition of the "at risk" rule. The "at risk" rule required that all production costs for film and television producers be capitalized, rather than deducted immediately. TRA '76 added section 465 to the internal revenue code section 704(d). Section 465 basically stated that businesses holding or producing films could only deduct the losses of an activity involved in film production to the extent the taxpayers were at risk in that activity. A taxpayer was only at risk for the cash and adjusted basis of property contributed to the activity, plus any loans the taxpayer was personally liable for. A taxpayer's non-

45 Id.
46 Id.
48 Mogulescu, supra note 41, at 841.
49 Id.
50 147 CONG. REC. S8476, supra, note 7 (statement of Sen. Lincoln).
52 Id. § 280.
53 Id. § 465(c)(3) (1982).
54 Id. § 465(b)(2)(A).
55 Id.
recourse debt used to finance the motion picture did not put the taxpayer at risk.\textsuperscript{56} This \textit{TRA '76} caused a major decline in film production because investors were unable to deduct most of the production expenses.\textsuperscript{57}

The only benefit to filmmakers that came out of \textit{TRA '76} was an investment tax credit.\textsuperscript{58} The tax credit was only available if the taxpayer had an ownership interest in the film\textsuperscript{59}, which tended to benefit the distributor, rather than independent film producers, film production or investors.\textsuperscript{60} The tax credit was a one-time benefit.\textsuperscript{61} Unfortunately, \textit{TRA '76} was overwhelmingly harmful to the production industry then a benefit, regardless of the tax credit for distributors. One of the things that pre-\textit{TRA '76} and the actual \textit{TRA '76} demonstrates, is the previous Congressional concern about and involvement concerning film production.

\textit{C. Tax Reform Act of 1986}

The 1986 Tax Reform Act revised the internal revenue code regarding the investment credit, to a certain extent.\textsuperscript{62} The enactment of the 1986 Tax Reform Act, read, in part, as follows in relation to the United States Independent Film and Television Production Wage Credit:

\begin{quote}
Amount of Credit-There shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to 20 percent of the qualified wages paid or incurred during the calendar year which ends with or within the taxable year.

Only First $20,000 of Wages Per Year Taken Into Account-

With respect to each qualified United States independent film and television production, the amount of qualified wages paid or incurred to each qualified United States independent film and television production employee which may be taken into
\end{quote}

\textsuperscript{56} \textit{Id.}

\textsuperscript{57} \textit{Id.}

\textsuperscript{58} I.R.C. § 48(k) (1982).


\textsuperscript{60} Mogulescu, \textit{supra} note 41 at 863.

\textsuperscript{61} I.R.C. § 48(k), \textit{supra} note 58 at § 48(k)(2) (1982).

account for calendar year shall not exceed $20,000.63

D. Prior Proposal

In the 106th Congress there was a legislative proposal offered involving wage credits, but the amendment never advanced.64 The proposal called for a wage-based tax credit to counter the loss of film production jobs to foreign countries, and provided: 1) a general business tax credit that would be a dollar-for-dollar offset against any federal income tax liability; 2) a credit cap at 25% of the first $25,000 in wages and salaries paid to any employee whose work is in connection with a film or television program substantially produced in the United States; and 3) availability of credit only to targeted film and television productions with costs of more than $500,000 and less than $10 million.65

The current amendment to the internal revenue code is quite similar to the proposal offered in the 106th Congress.66 Noting one major difference, the term “independent” is added to the film and television production wage credit.67

IV. RUNAWAY PRODUCTION HISTORY

Runaway production has been a problem since the middle of the twentieth century.68 “Today, runaway production ranks among the most critical issues confronting the entertainment industry.”69 There are many causes for the migration of film and television productions overseas.70 Some of these causes are integration, rising production and distribution costs, decreasing profits,
technological advances, government subsidies, and advantageous exchange rates.\textsuperscript{71}

The first of these causes mentioned, integration strategy, involves integration of economies around the world through trade and the movement of people and knowledge across international borders.\textsuperscript{72} When there are options in foreign countries that are less expensive, companies will and have started taking advantage of them, regardless of the consequences or loyalties to their own communities.\textsuperscript{73} In the last decade of the twentieth century, the United States saw a rise in production and distribution costs, thus, consuming large amounts of profits.\textsuperscript{74} “Production costs rose from an average of $26.8 million to $51.5 million.”\textsuperscript{75} “Distribution costs for new feature films more than doubled.”\textsuperscript{76} The rises in production and distribution costs caused a major decline in profits, therefore, driving film and television production overseas.\textsuperscript{77} The advances in technology allow films to be produced overseas without the added costs of transporting equipment.\textsuperscript{78}

Foreign countries are providing subsidies and tax credits to compensate for salary and wages, amounting to a large economic benefit for foreign production.\textsuperscript{79} Countries such as Canada, Australia, and New Zealand offer funding for equity investments.\textsuperscript{80} Because the United States dollar is stronger than the currency in the majority of other countries producers have more purchasing power when they produce in these countries.\textsuperscript{81} On the other hand, “The Canadian, Australian and U.K. currencies have all declined by fifteen to twenty-three percent, relative to the U.S. dollar, since

\textsuperscript{71} Id.
\textsuperscript{72} Monitor Report, supra note 17, at 24.
\textsuperscript{73} Id. at 3.
\textsuperscript{74} Dep't. of Commerce Report, supra note 3, at 60.
\textsuperscript{75} Id. at 62.
\textsuperscript{76} Id.
\textsuperscript{77} Id. at 63.
\textsuperscript{78} Id. at 62.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Monitor Report, supra note 17 at 3.
1990.”\(^{82}\) There are various causes that have implemented runaway production in the United States.

Concerns regarding the effects on cultural identity are also involved when runaway production occurs.\(^{83}\) Congress in the early 1960’s was warned of the trend of runaway production, and the possible impact it could have on worldwide mass communications.\(^{84}\) As H. O’Neil Shanks, John Lehners and Robert Gilbert of the Hollywood AFL Film Council testified in 1961, if Hollywood became “obsolete as a production center” and the United States voluntarily surrendered its position of leadership in the field of theatrical motion pictures, the chance to present a more favorable American image on the movie screen would be forever lost.\(^{85}\) The U.S. produced pictures are a medium through which our American values and morals of freedom are promoted.\(^{86}\) Runaway production is compromising the principle set forth by the previous statement.

V. CASE HISTORY

Litigation has been evolving regarding tax credits and general tax problems involving film producers and motion picture investors.\(^{87}\) Two cases that have been decided in the United States Court of Appeals for the Federal Circuit (hereinafter “Federal Circuit”) regarding tax credits for film and television are both part of this afore mentioned evolution of litigation. Both of these cases involved the issue of whether or not a production company has the

\(^{82}\) Id.


\(^{84}\) Id. at 498 (statement of H. O’Neil Shanks, Executive Secretary, Screen Actors Guild & Chairman, Foreign Film Committee, AFL Film Committee).

\(^{85}\) Id.

\(^{86}\) Ulich, supra note 68, at 368.

\(^{87}\) This is a general concept with several cases explicating this issue.
right to a tax credit under the current internal revenue code sections 38 and 48(k).\(^88\)

The case of *American Broadcasting Company* (hereinafter, *ABC*), involved the issue of whether or not *ABC* was eligible for an investment tax credit under the internal revenue code, sections 38 and 48(k) for episodes of *All My Children*, produced by *ABC* during the tax years of 1980-82.\(^89\) The *Federal Circuit* found that *ABC* was entitled to the tax credit under section 48(k).\(^90\) The *Federal Circuit* determined the language of the statute was not ambiguous as to the word “owner” of a film.\(^91\) The Federal Court ruled if something involved an audiovisual work, and a company holds the ownership rights of the authorship, the company is considered an “owner” for tax credit purposes.\(^92\) Therefore, if a company is considered an “owner” for tax purposes, as *ABC* was in this case, the company is entitled to the tax credit allotted to it under the internal revenue code section 48(k).\(^93\) Although the issue in this case did not involve a tax credit for independent film production wages, it demonstrates how cases involving tax law and film credits can be very ambiguous when the language of the internal revenue code is not clearly defined. As such, it demonstrates how important the exact wording of the proposed tax amendment, if passed, will be on its future application.

A second case, heard in the United States Court of Appeals for the Second Circuit (hereinafter “Second Circuit Court”), involved section 48(k) of the United States Code Annotated involving tax credits for film and television producers.\(^94\) This case was the *Goodson-Todman Case*, decided long before the *ABC* case, in 1986.\(^95\) In the *Goodson-Todman* case, the taxpayer argued that he was entitled to receive an investment tax credit with respect to


\(^{89}\) *Id.*

\(^{90}\) *Id.* at 1246.

\(^{91}\) *Id.* at 1243.

\(^{92}\) *Id.*

\(^{93}\) *Id.*

\(^{94}\) Goodson-Todman Enter. v. Comm’r of Internal Revenue, 784 F.3d 66 (2d Cir. 1986).

\(^{95}\) See generally Goodson.
production costs pursuant to section 48(k) of the internal revenue code. The television production involved in this case was a game show. There were two issues involved in this case. The first issue was whether or not the character and content of game shows preclude the categorical classification of “topical and transitory,” for the purpose of determining whether such shows may be entitled to investment tax credits. The second issue was whether or not producers of tapes of television game shows programs are entitled to receive an investment tax credit with respect to production costs. The Second Circuit Court held that the taxpayer was entitled to the tax credit. The Second Circuit Court reasoned on the second issue, in part, as follows: “Game shows are produced solely for broadcast, are watched for their entertainment value without regard to which contestants win or lose, and may be aired many times in many different towns over a period of months or years.” The Second Circuit Court, therefore, concluded that game shows were considered, for purposes of tax credits and the internal revenue code, to be included in section 48(k) of the internal revenue code. This case demonstrates the difficulty arising behind tax credits for film and television production because there are once again ambiguous sections to the internal revenue code. These two cases also exhibit that if the proposed legislation bill S. 1278 is passed, it will need to include very clear language as to who, what, when, and how the independent tax wage credit will be given.

VI. ANALYSIS

Runaway film production in the United States is not just an issue for Congress to examine, and research a monetary incentive to
solve. Runaway production is also a policy issue that must be looked into. There is major socioeconomic harm caused by runaway film production. Americans love movies, entertainment, and the idea of “Hollywood.” Watching movies and television is an American way of life. This American love affair must be preserved.

Runaway production affects more than just Hollywood and Los Angeles, it is harming the economic and social preservation in small cities and towns all over the United States. This article will provide examples of specific small towns and states this article will discuss, showing that film production in a small town not only increases the number of jobs, but it enhances the community. It brings towns together, allows opportunities for local town members to perform as extras in films, and it creates a “buzz” so to speak about the town the film is produced in.

One state that has experienced major perks from in state film production is Iowa. A small town in Iowa that was involved in film production was Dyersville, Iowa. The mega hit movie “Field of Dreams” was filmed in Dyersville. There were huge movie stars there, such as, Kevin Costner. This movie allowed for several town locals to pose as extras in the movie, and it created a huge inflow of visitors to the town to see the baseball diamond the movie used in the production of the film.

Yet, another example is the movie “The Bridges of Madison County,” filmed in Winterset, Iowa. This film drew a major influx of attraction to the town of Winterset, and the state of Iowa as a whole, because the book the film was adapted from was extremely popular through out the community of fiction readers. An example of how particular citizens of these towns are affected by film production is the story of a Winterset local, Chris Krone. He got his first major character acting opportunity from “The Bridges of Madison County,” because he resided in Winterset and

104 147 CONG. REC. S8476, supra note 7 (statement of Sen. Lincoln).
105 Field of Dreams, at http://www.fieldofdreamsmoviesite.com/
106 Id.
107 The Bridges of Madison County, at http://www.madisoncounty.com/Welcome.html
108 Interview with Chris Krone, Film Actor, in Chicago, IL. (June 5, 2000).
they auditioned local residents for some of the major film roles. These are just a few examples of how small towns and states not known for their movie production popularity have been benefited by local film production.

We need to get the producers to come back to the United States to preserve and restore the socioeconomic, cultural and economic benefits that film and television production bring to America. Because money drives businesses and the economy, the most promising way to bring production back into the United States is some sort of tax benefit or production tax incentive.

The promulgation of a tax wage credit for film producers is one that will most likely, from the evidence introduced, help the continual problem of runaway production. Because of the opposition to the tax credit legislation other avenues must be considered in dealing with the problem of runaway production. If this legislation does not pass and other options must be explored, it will be constructive to look into what other countries are doing to retain the film production industry within their domestic borders, and unfortunately, what is drawing the United States film production industry into their local borders also.

A. Other Countries

1. Canada

Canada is the United States' biggest competitor, securing the majority of runaway film productions. Canada held more than 90% of the runaway movies for television in 1998 alone. So, what is it that Canada is doing to lure in so many film and television productions? Canada offers a variety of wage and tax

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109 Id.
110 Dep't. of Commerce Report, supra note 3, at 1-90.
112 Monitor Report, supra note 17, at 9.
113 Id.
credits, financing packages, and funds for equity investments to encourage foreign production.\(^{114}\) "Canada offers working capital loans, tax credits and the waiving of local costs, such as parking and permits."\(^{115}\) Canada also offers incentives to its domestic film producers;\(^{116}\) a possible reason Canada has not had domestic runaway production problems like the United States has had in the last decade.

One of the domestic incentive programs offered only to Canadian production companies was introduced in 1998.\(^{117}\) This incentive was formed by the Film Incentive British Columbia (hereinafter “FIBC”), which made amendments to the British Columbia Income Tax Act.\(^{118}\) The amendments included three new initiatives to assist domestic producers and stimulate production outside of the Vancouver area.\(^{119}\) The incentives consist of refundable corporate income tax credits for Canadian producers.\(^{120}\) They include a tax credit on 20% of eligible labor costs, a tax credit on 12.5% of eligible labor costs, and a tax credit on the lesser of 30% of trainee salaries or 3% of eligible labor costs.\(^{121}\)

In 2000, the Minister of Canadian Heritage announced a new Canadian Feature Film Policy that established several incentive programs for both domestic and foreign production companies choosing to produce within Canadian borders.\(^{122}\) Both Federal and provincial governments in Canada offer these incentive programs to support domestic producers and to draw in foreign producers.\(^{123}\) Some other incentive packages, not afore mentioned, include aggressive marketing campaigns promoting feature films, and tax

\(^{114}\) Id. at 24-25.
\(^{115}\) Id. at 72.
\(^{117}\) Dep’t. of Commerce Report, supra note 3, at 75.
\(^{118}\) Id.
\(^{119}\) Id.
\(^{120}\) Id.
\(^{121}\) Id.
\(^{122}\) Dep’t. of Commerce Report, supra, note 3, p. 71.
\(^{123}\) Id.
shelters. The Canadian government has actively advertised their incentive packages to producers. "In some provinces, production houses get a tax credit of as much as 35% for money they spend on labor...Couple that with generally lower costs in Canada and a strong U.S. dollar, and the result is the defection of productions to Canada." 

Canadian tax shelters allow native investors to offer film-financing incentives in addition to tax credits. U.S. filmmakers are benefiting mostly from Canada’s Production Service Credits. U.S. producers can easily qualify for these credits by contracting for production services directly with Canadian companies. There are some expenditure criteria the U.S. producers must fulfill, but overall, they are not stringent criteria, and the credits are very advantageous for American producers.

An economic incentive very similar to the current legislation pending in the Senate today is the Canadian Federal tax credits compensation for salaries and wages. This incentive allows for a refundable corporate income tax credit, along with the waiver of several fees due to film production, for instance, parking, permits, and location fees. As can easily be envisioned, Canada’s several incentive programs encourage film producers to either stay in Canada if they are domestic, or come to Canada to produce films and television shows if they are foreign producers.

Canada has skyrocketed in the area of domestic film production recently. Canada has followed an integrated strategy approach resulting in this recent plummet effect of local production. An integrated approach to production occurs when a country that

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124 Id. at 72.
125 Id. at 73.
127 Id.
128 Id. at 72.
129 Id.
130 Id. at 73.
131 Dep’t. of Commerce Report, supra note 3, at 72.
132 Id.
133 Id.
134 Monitor Report, supra note 17, at 24.
begins with a relatively immature production industry. The country will begin to launch a series of initiatives to attract production activity within its borders, usually the incentives being tax credit centered. Along with these tax incentives the country will necessitate certain requirements that encourage the hiring of local personnel. As a result, local production crews, actors and managers gain experience training and become more appealing to other producers, while at the same time, the investments in physical infrastructures are sought so that more and more productions can be accommodated. As the production capabilities grow, other tax incentives are offered locally and internationally.

To illustrate the rapid increase in corporal infrastructures, British Columbia and Ontario hold almost 1.5 million square feet of sound stage space. The states of New York and North Carolina combined only hold 1.5 million square feet of sound stage space. If you exclude the city of Los Angeles (holding roughly four million square feet) in the U.S., and British Columbia and Ontario hold close to as much sound stage as the rest of the U.S. holds. When there is a large amount of sound space, as illustrated above, there is an attraction of production to the area because it generates the start up of service companies, such as, catering companies, equipment rentals, and post production companies. There is obviously an enticing alternative to production in the United States.

135 Id.
136 Id.
137 Id.
138 Id.
139 Id.
140 Id. at 23.
141 Id.
142 Id. (chart on p. 23) (source of chart: Film Commissions; Interviews; Reel West; Playback International; Montreal Shooting Guide)
143 See generally, at 23.
144 Id.
2. United Kingdom

The United Kingdom (hereinafter “U.K.”) has a 100 percent tax write-off incentive for both feature film and made for television production.145 The only criteria for this write-off advantage are: A majority of production uses U.K. or European Union nationals or residents, the producer uses U.K. studios for production, and that half of the technical production is supplied by U.K. companies.146 The U.K. even provides an alternative for this tax write-off incentive if the criteria are not met.147 The U.K. provides for a “leaseback” scheme.148 A “leaseback” occurs when a non-qualifying foreign production company sells its film rights to a leasing company, which, in turn, leases back the film rights to the production company. The transaction allows the U.K. lessor to take advantage of tax relief; the value of the benefits is divided between the U.K. partner and the foreign production company.149

The “leaseback” scheme is still more enticing than any incentives we have in the United States, and it is just an alternative to their “luring” tax incentive scheme! Even beyond these government based incentives, the British Screen Finance, a publicly supported film investment company, offers commercial loans for film projects to British filmmakers that would be unlikely to receive backing on their own from a bank or commercial institute.150

The business of film production is recognized all over the world, as demonstrated by a recent announcement made by the European Union in 2000.151 This announcement involved a 50 million Eurodollar (approximately $45 million American dollars) fund to help European media companies to compete with Hollywood in the area of small and medium sized film production.152 The

145 Dep’t. of Commerce Report, supra note 3, at 77.
146 Id.
147 Id. at 78.
148 Id.
149 Id.
150 Id. at 79.
151 Id.
152 Id.
European Investment Bank will provide the money to fund this media plan.\textsuperscript{153}

3. Australia

Australia’s economic plan mainly supports domestic films, but even it has foreign film production incentives.\textsuperscript{154} These incentives range from payroll tax rebates to exemptions.\textsuperscript{155}

4. Ireland

Ireland is another country that is becoming attractive to foreign film producers.\textsuperscript{156} The main incentive offered by Ireland is a non-refundable subsidy of up to 12\% for film production.\textsuperscript{157} This subsidy may not sound as appealing as the other countries incentives, but it has made an impact on American producers who spent an estimated 61.9 million in production in Ireland in 1999.\textsuperscript{158} Besides the tax incentive, producing in Ireland is attractive to foreign producers because they can avoid the European Union’s quotas, and Ireland is known by producers and the population alike to be an island with very beautiful and unique countryside.\textsuperscript{159} Both of these reasons help draw production into Ireland.

\textit{B. Back Home in the United States}

How do these foreign countries attract producers to make films where the scenery of the film is set in the United States? Due to recent technology, this is no longer a problem.\textsuperscript{160} Current technology makes it possible to create sets and special effects

\textsuperscript{153} Id.
\textsuperscript{154} Id. at 80.
\textsuperscript{155} Id.
\textsuperscript{156} Id. at 81.
\textsuperscript{157} Id.
\textsuperscript{158} Id. at 82.
\textsuperscript{159} Id.
\textsuperscript{160} Id.
imitating American soil.\textsuperscript{161} With this added technology, film producers in other countries are researching exactly how to portray American cities in films produced abroad.\textsuperscript{162} For example, the classic movie, "Blues Brothers" was filmed in Chicago several years ago.\textsuperscript{163} The producers decided to film the sequel to the movie in Canada.\textsuperscript{164} The Canadian film producers called the Chicago film commission to ask them how to best portray Chicago when filming the sequel.\textsuperscript{165}

If the United States is going to combat the problem of runaway production, it needs to consider the incentives of these other countries. If this pending legislation does not pass, Congress will need to consider alternative options to save the film production economy.

One alternative would be to apply some of the foreign tax incentives other countries offer to get film production back into the United States. The problem with this alternative is that most of the other countries' tax incentives include tax credits. If S. 1278 does not pass, Congress is not likely to pass legislation involving tax credits for film producers, stemming from other countries' tax plans.

As stated above, Ireland gives a subsidy to film producers.\textsuperscript{166} This is an alternative to the current tax code in the United States, but would basically involve giving a discount or large tax credit off of the total cost of producing a film. This alternative is an unlikely one for the United States because a subsidy of a certain percent is essentially a tax credit, a dollar for dollar tax credit on a certain percentage of the money spent on production.

Another reason many of the foreign tax incentives would be obstinate to pass in our Congress is our current tax system. The United States tax system is governed by the internal revenue code,

\textsuperscript{161} Id. at 4.
\textsuperscript{163} Id.
\textsuperscript{164} Id.
\textsuperscript{165} Id.
\textsuperscript{166} Dep' t. of Commerce Report, supra note 3, at 81 (a subsidy is a dollar for dollar grant of governmental aid; often given for a certain percentage of costs to aid or encourage economic activity).
a very detailed and precise instrument, that treats deductions and credits as a “grace” to the taxpayer, not an absolute or a right inferred upon American citizens and businesses.\textsuperscript{167} Meaning, the Constitution of the United States does not include language that infers a constitutional right to tax deductions or tax credits, but Congress has added certain deduction allowances into our internal revenue code for particular policy reasons.\textsuperscript{168}

Alternatives must be considered that are more conducive to the current United States internal revenue code, and one alternative would be to allow a production company to expense the total cost of production, not just the cost of wages,\textsuperscript{169} during the year of production. In the United States’ current internal revenue code there are two main options for treatment of business costs on tax returns.\textsuperscript{170} One option is to deduct the expenses.\textsuperscript{171} This means that after the taxable income is figured, a certain amount is deducted, making the total taxable income lower and thus, the amount a taxpayer pays tax on lower.\textsuperscript{172}

Most taxpayers prefer to deduct expenses, but this is not always possible. The other option is to capitalize the expenditure.\textsuperscript{173} When the expenditure is capitalized, the basis\textsuperscript{174} will usually still be regained eventually, just not right away, as it is when the option of deducting is utilized.\textsuperscript{175} The basis will be regained either through depreciation, or the selling of the asset, but in rare cases the taxpayer will not regain the basis.\textsuperscript{176} Capitalizing is less

\textsuperscript{167} Professor Philip Ashley, Federal Taxation & Tax Policy: Course Lecture, DePaul College of Law (Sept. 17\textsuperscript{th}, 2001).
\textsuperscript{168} Id.
\textsuperscript{169} See generally Internal Revenue Code § 162 (wages are almost always a deductible business expense).
\textsuperscript{170} Id.
\textsuperscript{171} Id. supra note 169.
\textsuperscript{172} Id.
\textsuperscript{173} Id. (an expenditure is capitalized, unlike an “expense” which his deducted).
\textsuperscript{174} (“Basis” is essentially the investment in the property, what one has got in it, what one needs to get back to break even).
\textsuperscript{175} Id. supra, note 169.
\textsuperscript{176} See Section 165 of the Internal Revenue Code (generally). See also §1001 (when the basis is regained through selling an asset, §1001 governs the
favorable because the basis is regained later, and the time value of money makes it favorable to regain the basis as soon as possible.\textsuperscript{177} Time value of money is important because the sooner the company has the money its possession the sooner it can invest that money and start earning interest on it, or the business can reinvest that money into other assets for the company.\textsuperscript{178} This alternative of allowing the production company to deduct all of the production expenses, would allow the production company to choose option one, deducting expenses versus capitalizing the expenses.

Assuming the unavoidable argument, that this alternative is still too lenient to production company taxpayers, another way to increase U.S. film production would be to allow accelerated depreciation on film and television production costs.

The costs to production companies for wages of the employees working in production are currently expensed on the production company’s tax return.\textsuperscript{179} This means that they can deduct the wages from the current year when determining the total taxable income to the production company.\textsuperscript{180} As afore mentioned, the current internal revenue code there illustrates two main options for the treatment of business expenses: to expense them as recently explained, or to depreciate them.\textsuperscript{181} When a business has other costs, other than wage and salary expenses,\textsuperscript{182} those costs are usually depreciated throughout a certain number of years to regain

calculation of [amount realized – adjusted basis] which deciphers a gain or loss from the sale of the asset).

\textsuperscript{177} Professor Philip Ashley, DePaul College of Law, Policy Packet for Federal Taxation & Tax Policy, § IX, The Time Value of Money (Fall 2001) (A dollar today is more valuable than a dollar in the future; if one is given a dollar today it is worth a dollar, if one is told they will be given a dollar in a year, in reality that means less than a dollar today).

\textsuperscript{178} Id.

\textsuperscript{179} See generally Internal Revenue Code.

\textsuperscript{180} U.S. Tax Reporter §162(a)(1), ¶1620, p. 17,771 (Nov. 5\textsuperscript{th}, 1998) [hereinafter Tax Reporter].

\textsuperscript{181} Id. at ¶167, ¶1674, p. 21,215 (Oct. 24\textsuperscript{th}, 1996).

\textsuperscript{182} Id. (citing existence of other costs and expenses besides salary and wage expenses that are expensed and not depreciated and are listed in §162 of the Internal Revenue Code).
the original basis,\textsuperscript{183} or investment in the product, or in this case the investment in producing the film or television show. For most investments the internal revenue code gives a set amount of years that a company must use to depreciate an investment, set by the internal revenue code.\textsuperscript{184} In film production, the amounts paid or incurred in the production of the film, generally, other than wages,\textsuperscript{185} are capitalized, or depreciated.\textsuperscript{186} The deductions in any taxable year are determined by a derived ratio for the amount the production company reasonably expects to earn from the film.\textsuperscript{187} This method of deriving a ratio for the number of years to depreciate is called the income-forecast method.\textsuperscript{188}

The income forecast method is used in films and television films because the regular depreciation methods do not always serve the basic purpose of depreciation, which is to offset the cost of an asset against the income it produces.\textsuperscript{189} To counter this irregularity, film and television film producers take the cost to produce the film or television production, and then estimate the income for the next X amount of years that are expected to flow in as profits from the production.\textsuperscript{190} These amounts are then depreciated in the amount per year for the next X amount of years until the production costs are capitalized.\textsuperscript{191} In other words, the amounts are depreciated until the basis is regained.\textsuperscript{192}

\textsuperscript{183} 26 U.S.C.A. § 1012 ("basis" is an accounting term used to define generally, the investment in the property, what you've got in it, what you need to get back to break even; basis is not to be misconstrued to mean "value").

\textsuperscript{184} See generally Internal Revenue Code.

\textsuperscript{185} Tax Reporter, supra note 163, at §167, ¶1674.031, p. 21,226B (March 2\textsuperscript{nd}, 2000) (there are some other production expenses that are not capitalized besides wages, §167 allows drawings, tracings, blueprints, models, and similar items, and special tools such as jigs, dies and patterns used on or with production equipment, may be expensed or depreciated depending upon the useful life).


\textsuperscript{187} Id.

\textsuperscript{188} Tax Reporter, supra note 180, at §167, ¶1674.100, p. 21,242 (June 11\textsuperscript{th}, 1998).

\textsuperscript{189} Id. at §167, ¶1674.100, p. 241,243 (June 24\textsuperscript{th}, 1999).

\textsuperscript{190} Id.

\textsuperscript{191} Id.

\textsuperscript{192} Id.
What is so bad about regaining the basis with separate amounts per year, estimated by the film producer? The problem is that the sooner one can depreciate their costs or get a higher tax deduction, in turn, the later one has to pay the government higher tax dollars, the more advantageous it is to the taxpayer.\(^{193}\) This is because of the time value of money.\(^{194}\)

The present value of cash flow today is very valuable, and as time goes by the less valuable the cash inflow earned today becomes.\(^{195}\) This is one of the main driving factors behind tax litigation. Many taxpayers are trying to pay less in taxes now, in other words, take more deductions off of their income taxes today so they pay less tax today. When a taxpayer pays less in taxes now they have more money at their disposal now leaving them more money to put into the economy by way of investments or spending.\(^{196}\) The government has an opposing position, trying to get more tax dollars from taxpayers today, while waiting until a later date to give tax breaks and deductions to taxpayers.\(^{197}\) While there may be many alternatives to the current depreciation method, this article will discuss two that seem quite promising.

\textit{C. Alternatives to Bring Production Back to the United States}

\textit{1. Allowing All Costs To Be Expensed}

The first alternative is to allow film and television production companies to expense the entire cost of production, as they do with wages and salaries. This would allow the cost of production to be expensed in the first year,\(^{198}\) when the time value of money is the most preferable, and it would allow the production company to regain its basis within one year from production costs. This may

\(^{193}\) See supra note 177.
\(^{194}\) Id.
\(^{195}\) Id.
\(^{196}\) Id.
\(^{197}\) Id.
\(^{198}\) See generally, supra note 169-173.
be considered extreme by Congress, as many tax deduction proposals often are, but would encourage production companies to start producing in the United States again. It would permit companies to put money into other film productions faster if they regained their basis from production expenses on their foregoing film within one year.

One Congressional argument against this may be that when business expenses are deducted and not treated as expenditures, which are capitalized, Congress is already acting very generously. America only has a constructive receipt doctrine and not a constructive deduction doctrine. Although this is true, deductions are “gifts,” for the lack of a better word, by the legislation; we are trying to combat a major area of economic loss in this situation. An act of “grace” may be not just kind, but extremely necessary when our country has lost approximately 10 billion dollars in the last decade due to increasing problem of runaway film production. This fact becomes even more significant when the trend of increased runaway production is examined. The economic loss from runaway production in 1998 was five times the economic loss from runaway production in 1990, just eight years earlier. This is a problem that is exponential as the years go by, not steady.

2. Allowing Accelerated Depreciation

A surrogate alternative to this would be to allow accelerated depreciation on the costs of production. This alternative, while not as munificent to the production companies, has a better chance of

199 Professor Philip Ashley, Federal Taxation & Tax Policy: Course Lecture, DePaul College of Law (Oct. 15th, 2001) (see supra note 167 & 168 to clarify these concepts of constructive receipt doctrine and constructive deduction doctrine).
200 Monitor Report, supra note 17, at 2.
201 Id.
202 Id.
passing through legislation. This alternative can best be understood through an example of a production company’s income forecast analysis.

In order to provide an example of a production income forecast analysis several assumptions must be made: 1) the income forecast analysis indicates that the film will produce an even amount of income over four years from the film’s profits, 2) the company spends one million in production costs after wages and salaries are paid, 3) this amount of one million in costs is all going to be capitalized and 4) the company expects to receive two million in revenue from the film over four years. According to the current internal revenue code, and given these hypothetical assumptions, the company would depreciate the one million in expenses of production over the amount of years derived in the specified ratio of the film earning an equal amount of profit over four years from the film. The production company would depreciate $250,000 per year for four years until all of the costs have been depreciated.

Now consider applying the alternative described above, accelerated depreciation in two years. This alternative suggests that the internal revenue code could be amended to allow all of the depreciation to occur within two years for film production costs. The company would still use the income forecast method to determine what would happen with estimated profits in the first year. The company would take the normal depreciation deduction in year one. Then, in year two the company could depreciate the remaining amount. Films do, in fact, make profits from film and television productions long after a film is released, money is made on film rentals, promotional cable television film showings, re-releases of films, etc. As such, this alternative would encourage production in the United States, because production companies would be assured they could regain their basis in two years, instead of in several years, if the film is projected to produce income for several years.

203 See generally id. Note that the government is more likely to pass legislation that is not as dramatic, and also legislation that is more preferable to the government earning more rather than less tax income from taxpayers.
This alternative may be easier to pass in Congressional legislation. This is because the first year of a film or television broadcast release normally earns the largest portion of income due to the money made in the theatres and on first time watchers. In the following years, the excitement of a new production wears down and the film begins to make less money as the years proceed. This two-year acceleration of depreciation plan would really only detriment the tax revenue to the government on the years subsequent to the first year. Since, the years following the first year are usually estimated to bring in less profit, the production company would see the benefit more profoudly then the government would see the shortcoming. The government already allows the film production industry to estimate the income they expect to receive and take a large deduction in the first year because of the weight method already in place in the internal revenue code. Essentially, it would only be the added deduction in year two from the years consequent to year two that would be accelerated. Another positive for the government within this alternative is that it leaves the taxpayer with more money today, which the taxpayer can reinvest at prevailing interest rates.204 Any time a taxpayer is investing money today, it boosts the economy, and the government will always encourage a strong economy. As such, this second alternative is a balance between governmental interests that are very well founded and the mending of the runaway production epidemic facing the United States today.

VII. CONCLUSION

Runaway production has become a catastrophe in the United States in the last decade; causing a serious loss in jobs, film production economy and tax revenues.205 There is current legislation pending, and if passed, will hopefully begin to repair this economic calamity.206 The suggested legislation is to amend the internal revenue code to allow for an independent film

205 Dep't. of Commerce Report, supra note 3 at 1.
206 Television Production Incentive Act, supra note 1.
production tax wage credit.\textsuperscript{207} The legislation is presently under consideration in the Senate.\textsuperscript{208} The motion picture tax incentives offered before 1976 did increase film and television production in the United States, however after the Tax Reform Act of 1976, the reform actually decreased production in this country.\textsuperscript{209} There is need for reform again today, and reform that will the film and television production industry back to America. The massive loss to our American economy, caused from runaway production has had a major effect on small and large cities and communities throughout the United States.\textsuperscript{210} Numerous jobs and several billions of dollars have been lost in the last decade due to runaway production.\textsuperscript{211} Hopefully, Congress will realize how important this bill is to repair the damage that has already been done, and the harm that could and will, most likely, be done if the problem persists. If this legislation is not passed, there are other options and these options must be explored. It is pertinent to a major industry in the United States, an industry the United States has built, and come to identify with and love.

\textit{Courtney Siders}

\textsuperscript{207} \textit{Id.}
\textsuperscript{208} \textit{Id.}
\textsuperscript{209} Mogulescu, \textit{supra} note 41 at 841.
\textsuperscript{210} 147 CONG. REC. S8476, \textit{supra} note 7, (statement of Sen. Lincoln).
\textsuperscript{211} \textit{Id.}