

Wisconsin

where originality rules



COST BENEFIT ANALYSIS OF WISCONSIN FILM TAX CREDIT PROGRAM

March
2009



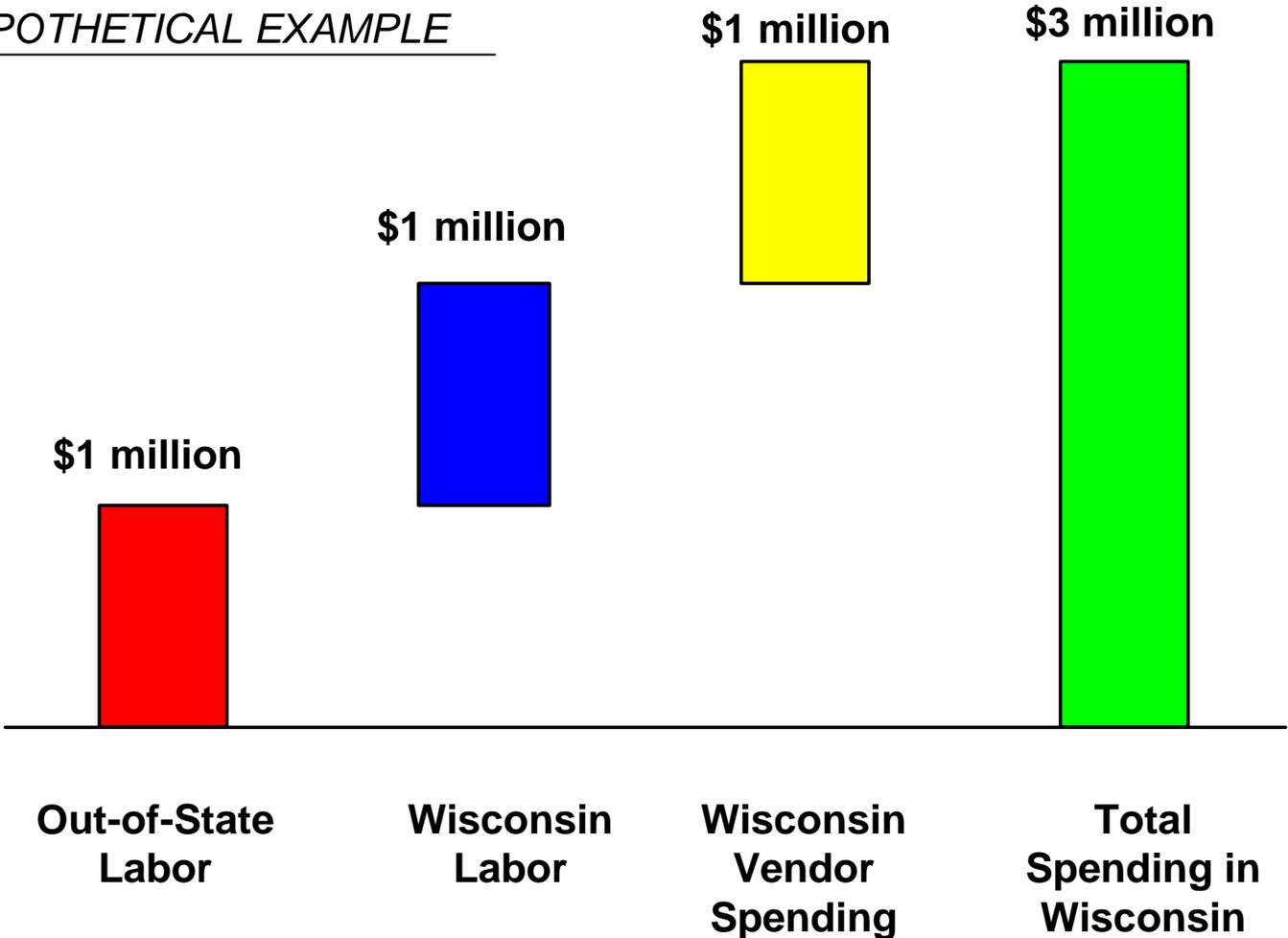
Commerce's Position on Film Tax Credits

1. Commerce believes creating permanent jobs in creative industries like film and video games is an admirable goal, and one that we share
2. Commerce believes there is massive confusion about how the existing program actually works
3. Commerce feels a duty to raise the warning flag and draw attention to several fundamental flaws in the program:
 - The program's flaws create an incentive to hire out-of-state contractors instead of Wisconsin labor
 - The program is really expensive because it is a refundable tax credit program, not just a tax credit program.
 - The program's cost-benefit analysis compares poorly to other programs aimed at manufacturing, technology, and agriculture
 - In fact, Commerce can offer much more assistance to a film or video game than a manufacturer, a biotech start-up, or a cheese plant
 - The program is an unlimited liability for Wisconsin...Louisiana just got a bill for \$266 million. That could happen here.

Flaw #1: The Program Operates Differently than Assumed

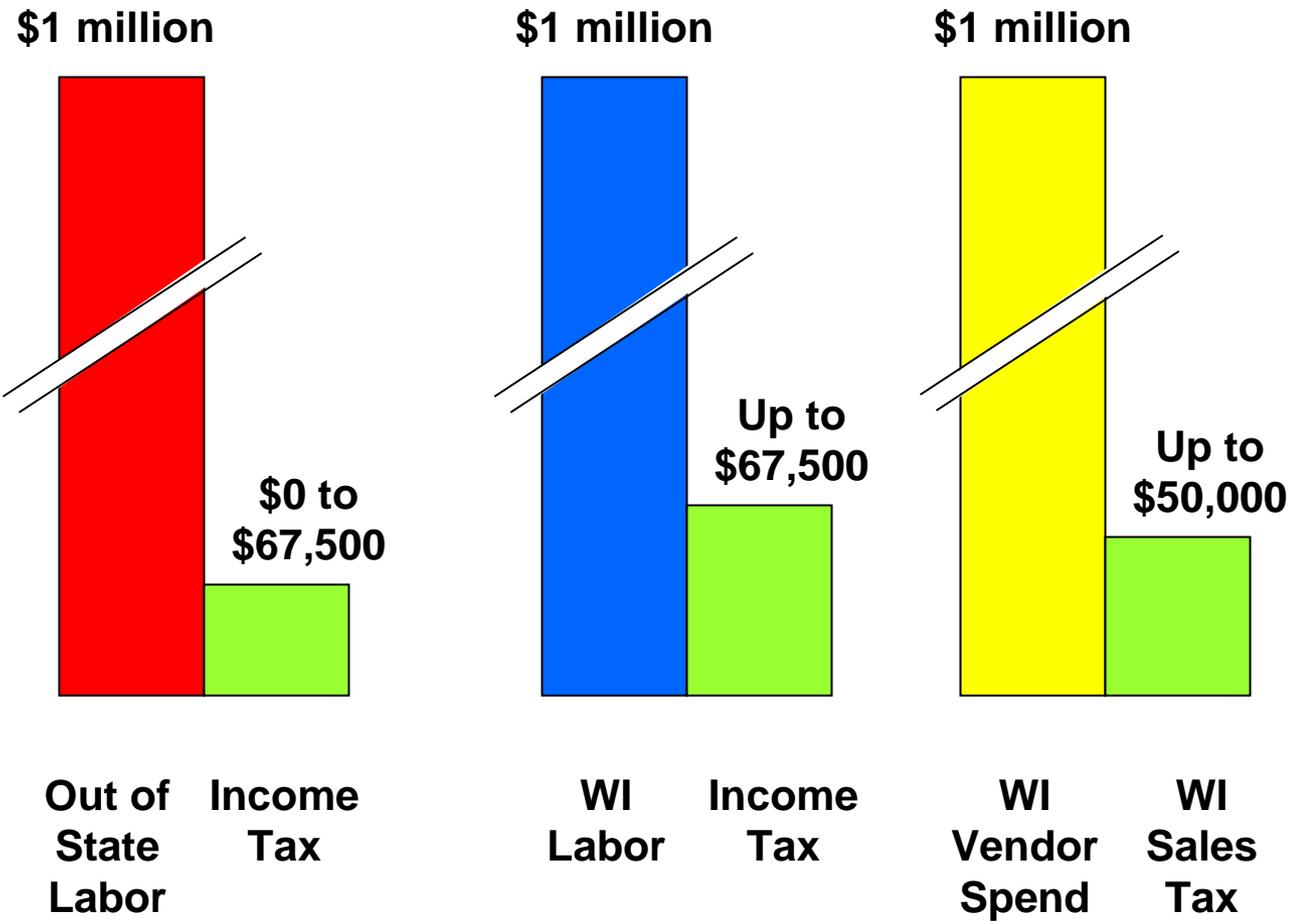
Imagine a film comes to town and spends \$3 million - \$1 million on Hollywood labor, \$1 million on Wisconsin labor, and \$1 million on taxable supplies and services purchased through Wisconsin vendors

HYPOTHETICAL EXAMPLE



Taxes Generated By Our Example

HYPOTHETICAL EXAMPLE

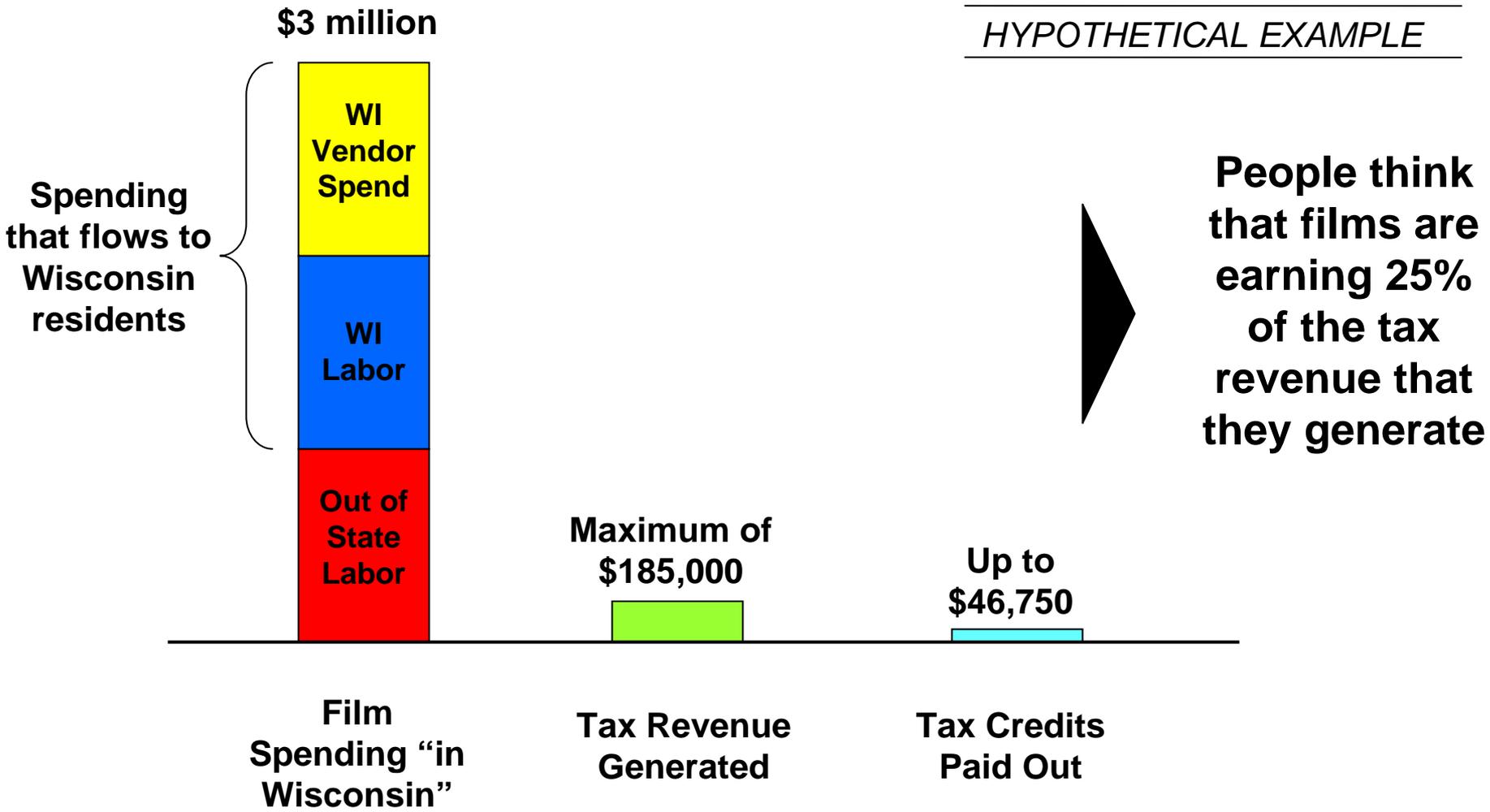


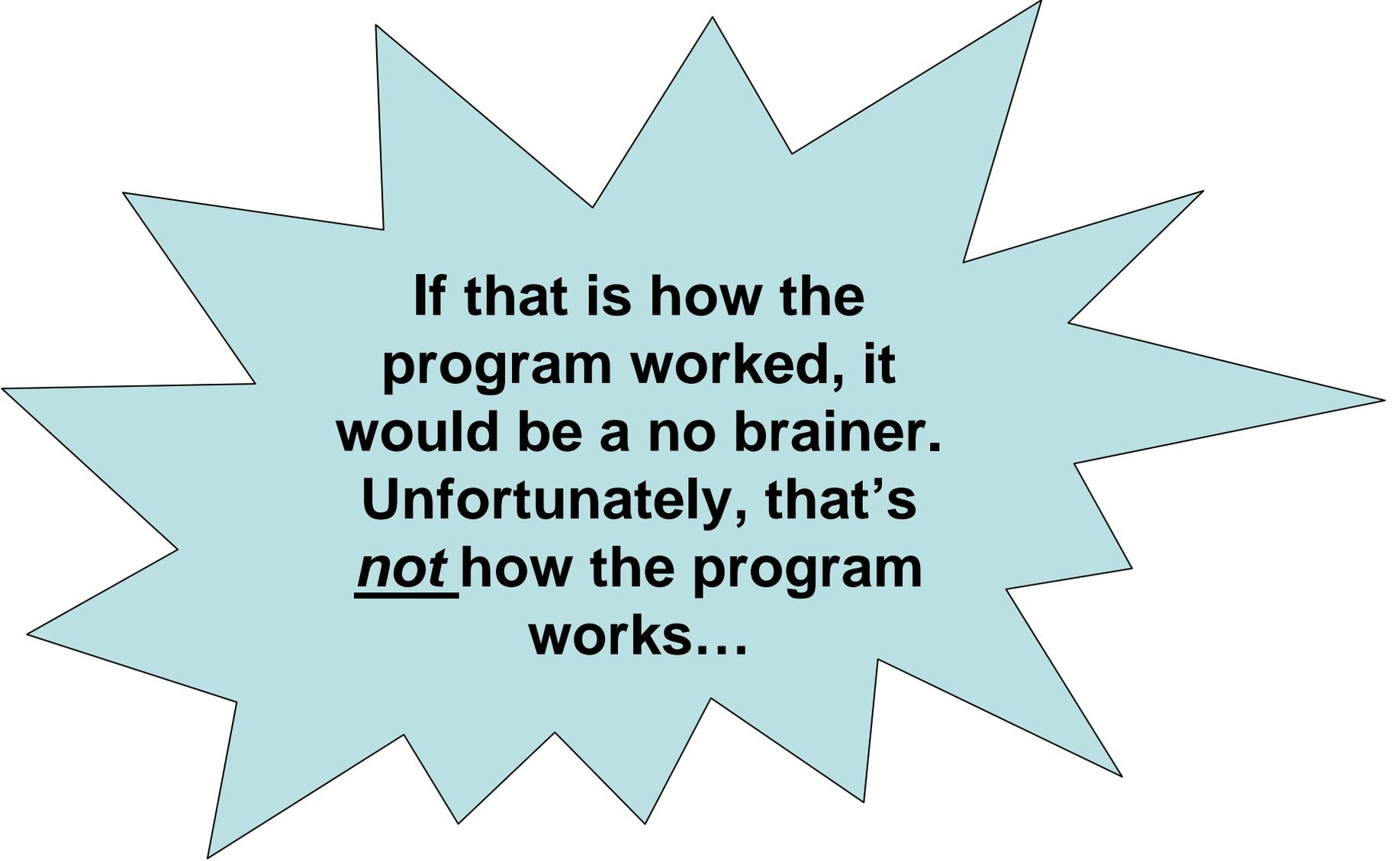
The \$3 million spend would generate a maximum of \$117,500 to \$185,000 in state tax revenue

Based on Wisconsin's top marginal rate of 6.75% for income tax and 5% on sales tax

How People Think the Program Works

“In order to have this industry in Wisconsin you have to offer incentives. The basic equation has always been 75 percent of something is always better than 100 percent of nothing.”

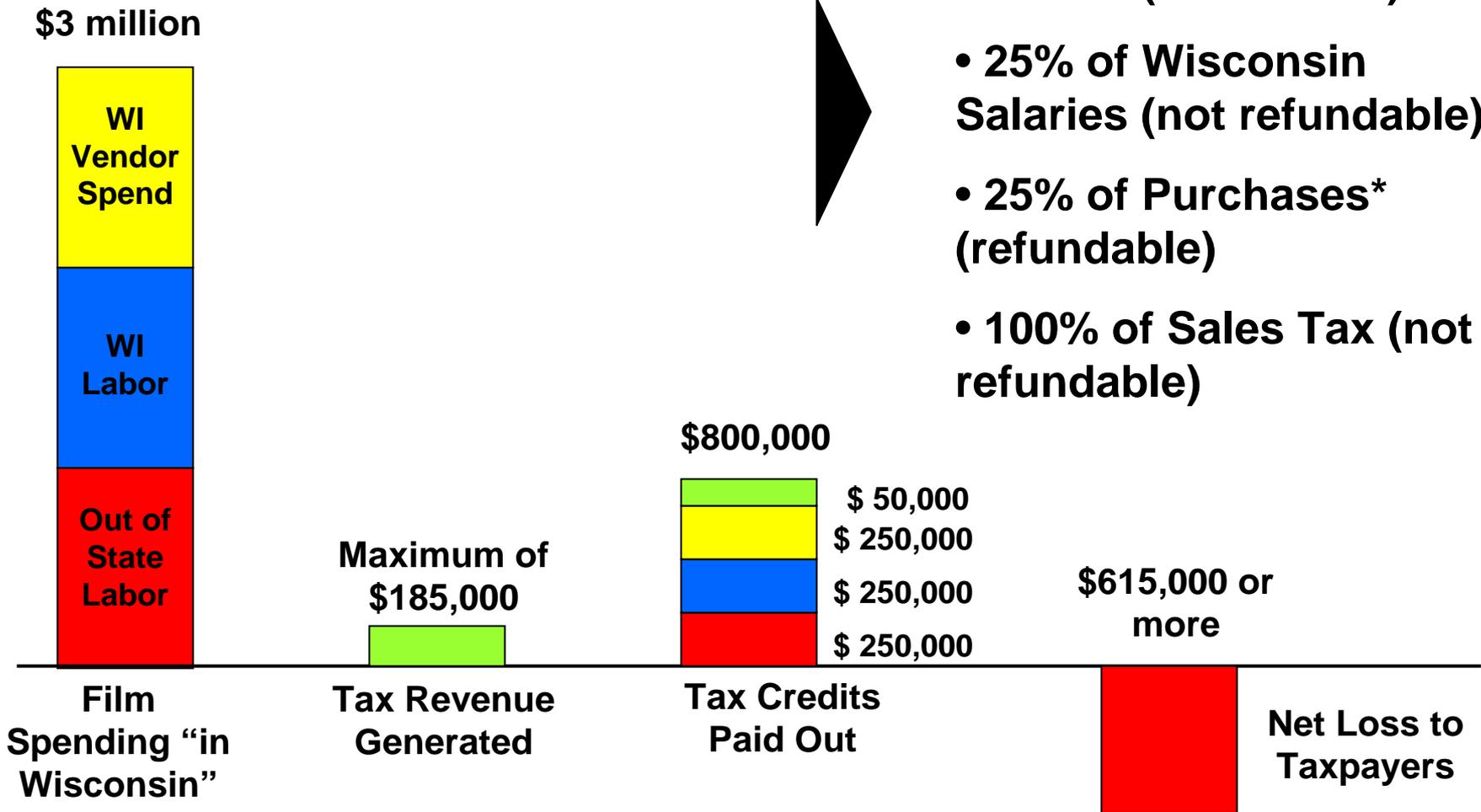




**If that is how the
program worked, it
would be a no brainer.
Unfortunately, that's
not how the program
works...**

How the Program Actually Works

HYPOTHETICAL EXAMPLE



Wisconsin actually pays:

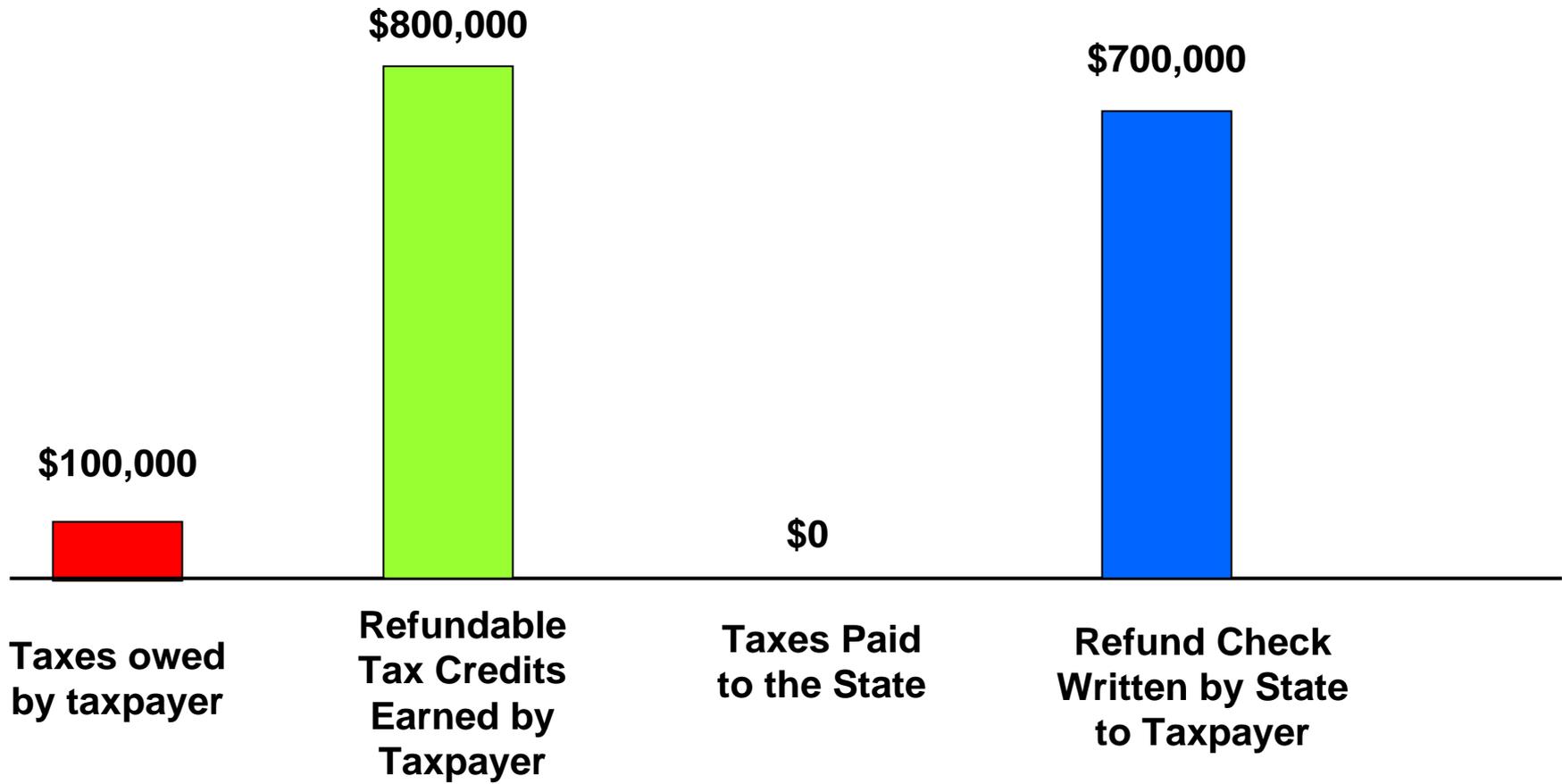
- 25% of Hollywood Salaries (refundable)
- 25% of Wisconsin Salaries (not refundable)
- 25% of Purchases* (refundable)
- 100% of Sales Tax (not refundable)

* Does not have to be purchased from a Wisconsin vendor to qualify (except for music, air travel, and insurance)

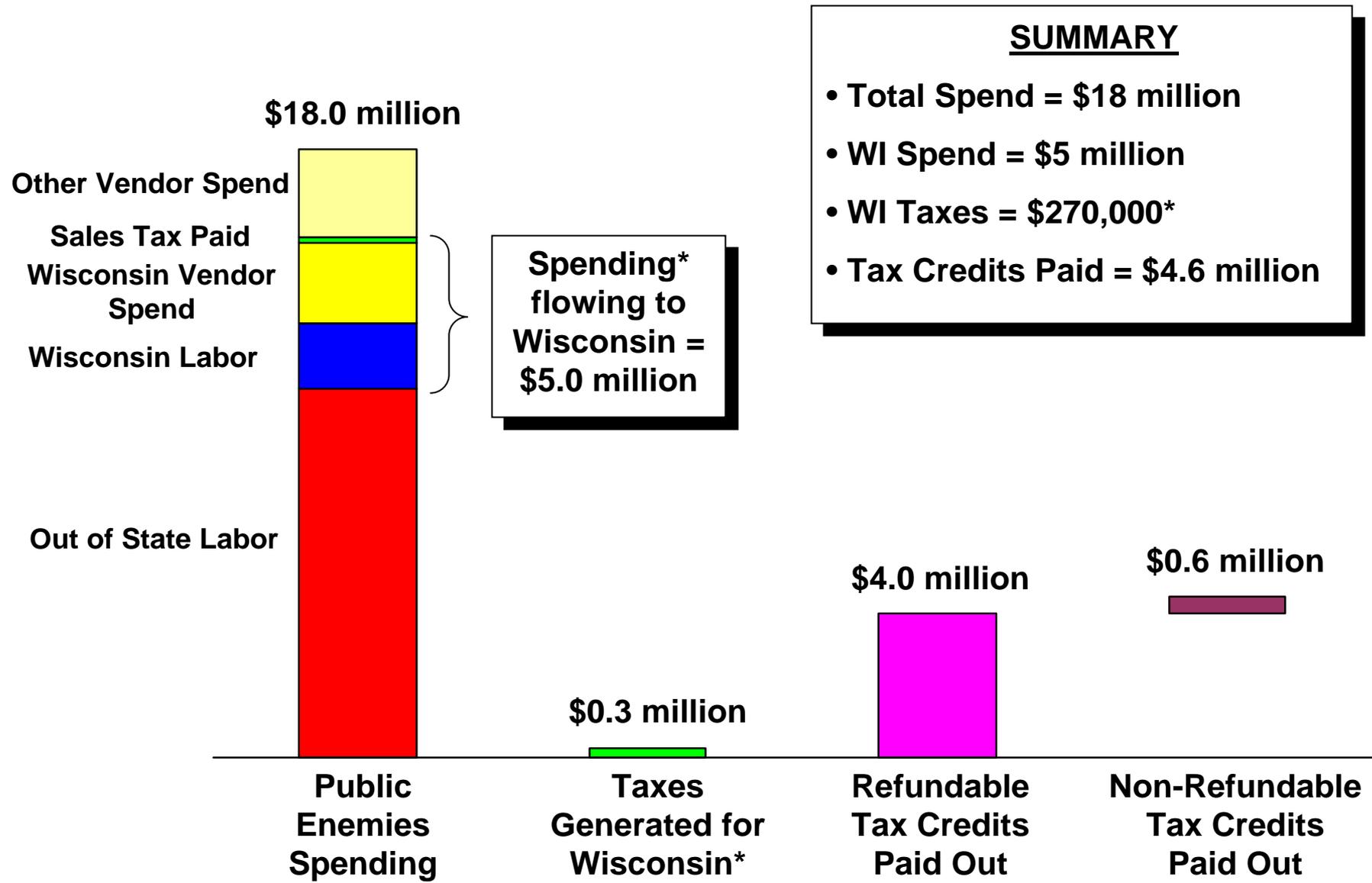
Plus Most of the Credits are Refundable

A refundable tax credit is like a grant program. If the refundable tax credit exceeds the recipients tax bill, the state writes a check for the difference.

HYPOTHETICAL EXAMPLE



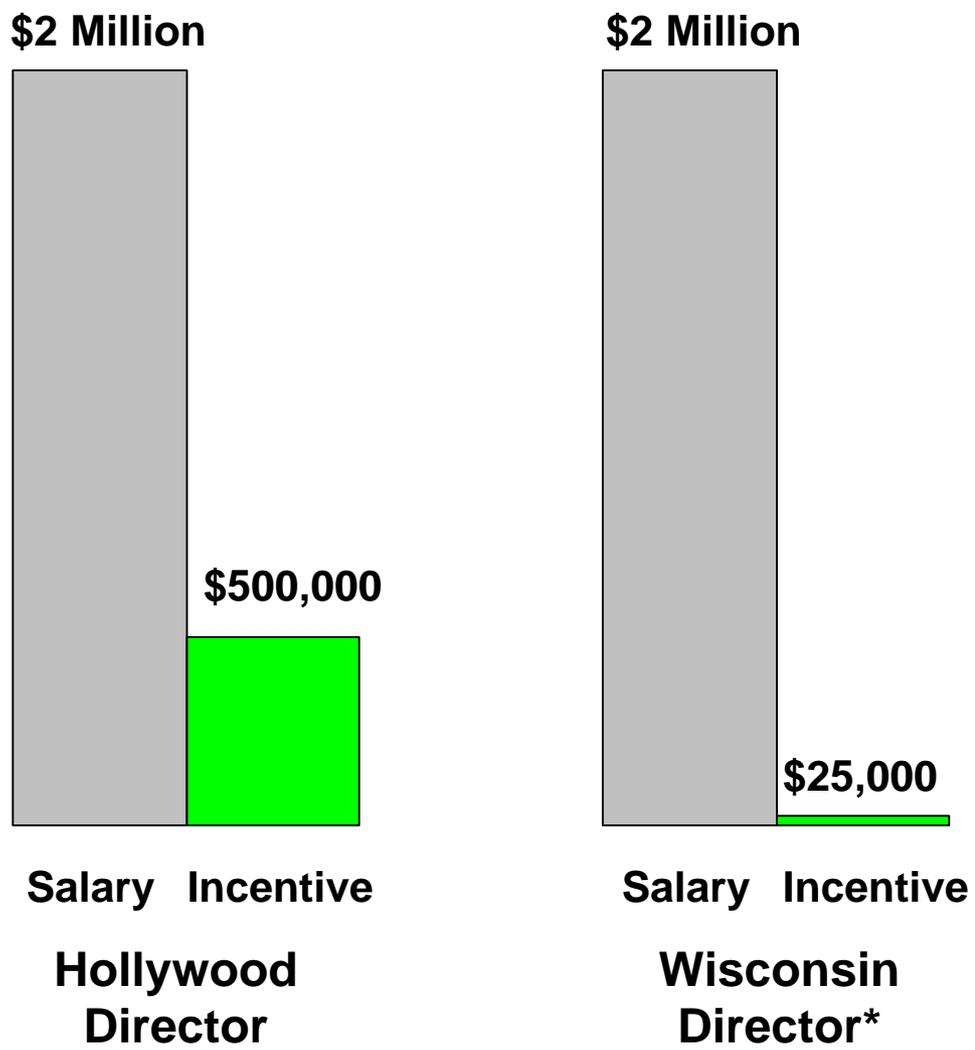
How this Worked for Public Enemies



* Also includes estimates of income tax paid in Wisconsin

Flaw #2: The Program Is Biased Toward Out-of-State Labor

MAXIMUM INCENTIVE EARNED ON A \$2 MILLION SALARY

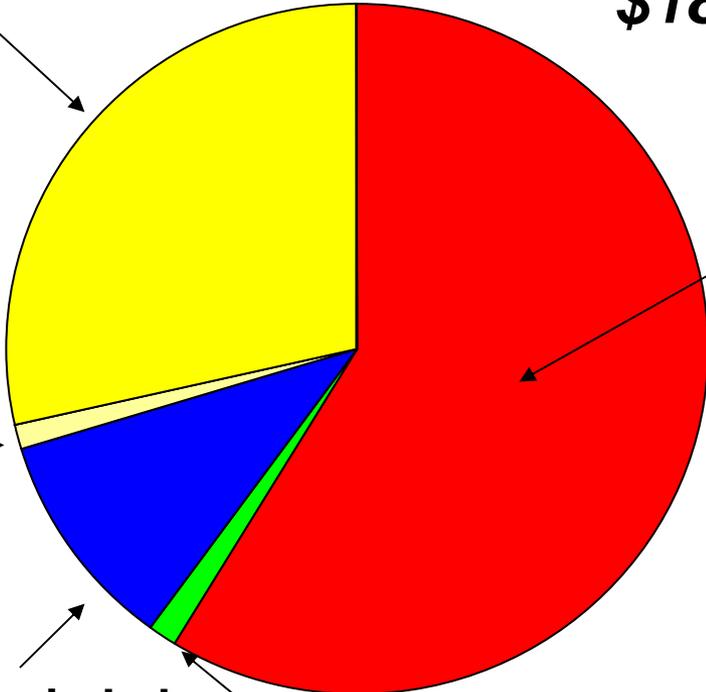


A film can get 20 times more by importing a Hollywood Director instead of hiring a Wisconsin resident

* If the Wisconsin Director was one of the 2 highest paid employees, the incentive for the Wisconsin Director would actually be \$0

Flaw #3: Program Subsidizes Non-Wisconsin Benefits

**Public Enemies Spend:
\$18 Million**



Misc. Purchases

\$5.2 million

- Housing/Hotels
- Travel/Gas/Tolls
- Craft Services
- Meals
- Per Diems

Wisconsin Purchases Assets & Rentals

\$192,000

- Construction materials
- Supplies
- Set dressing/props
- Cars

Wisconsin Labor

\$1.9 million

- Construction
- Misc. Labor
- Extras

Wisconsin Taxes

\$270,000

- Sales
- Income

Out-of-State Labor

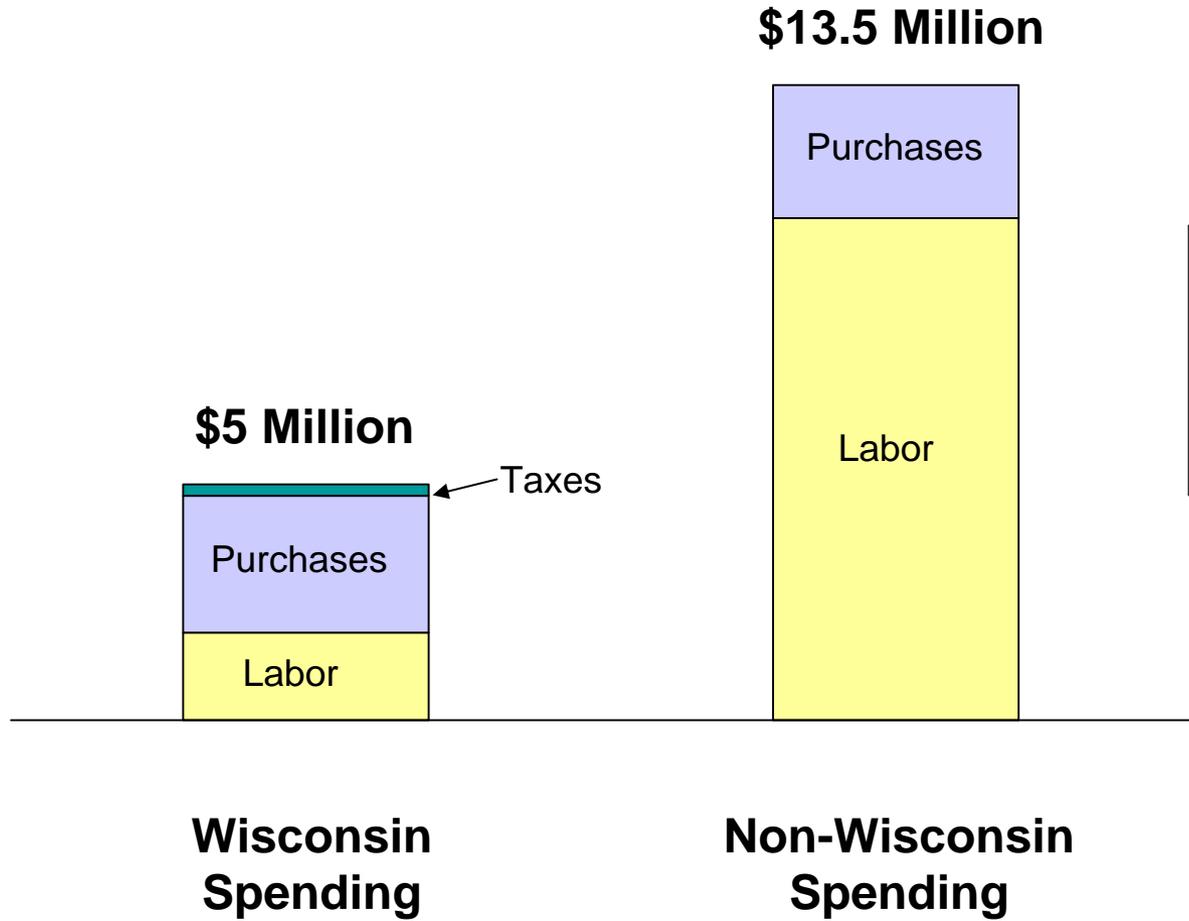
\$10.7 million

- Producers & Production
- Director & staff
- Drivers
- Camera Operators
- Construction
- Lighting
- Special Effects
- Extras
- Makeup/Hair
- Chefs/Servers

Source: Commerce data; NOTE: Includes income tax estimates for Wisconsin labor

Most Public Enemies Spending Left Wisconsin

PUBLIC ENEMIES SPENDING BY CATEGORY

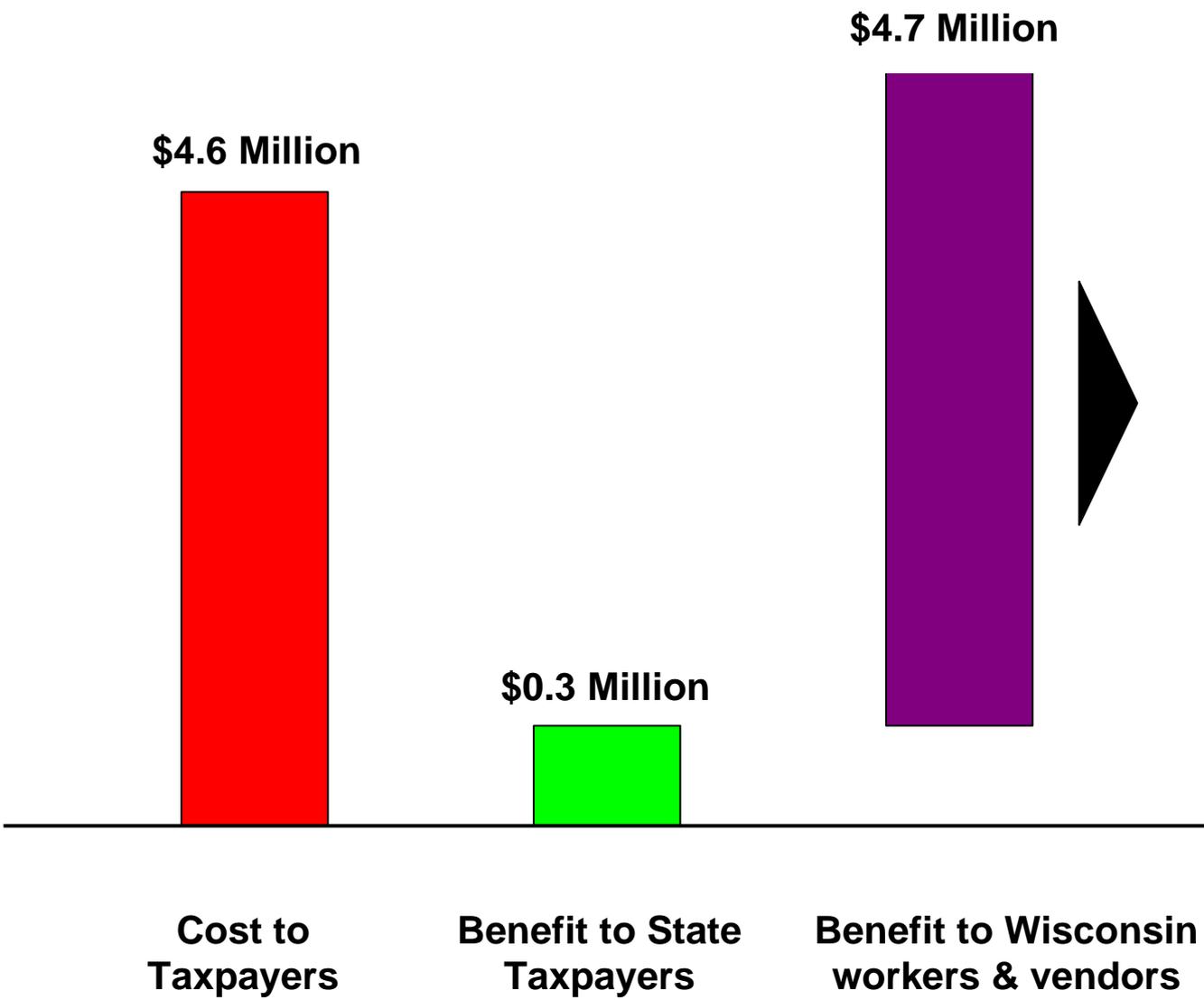


Only 27% of spending benefitted Wisconsin even though Hollywood received subsidy on 100% of spending

Source: Commerce data

Flaw #4: The Program Is Not Cost Effective

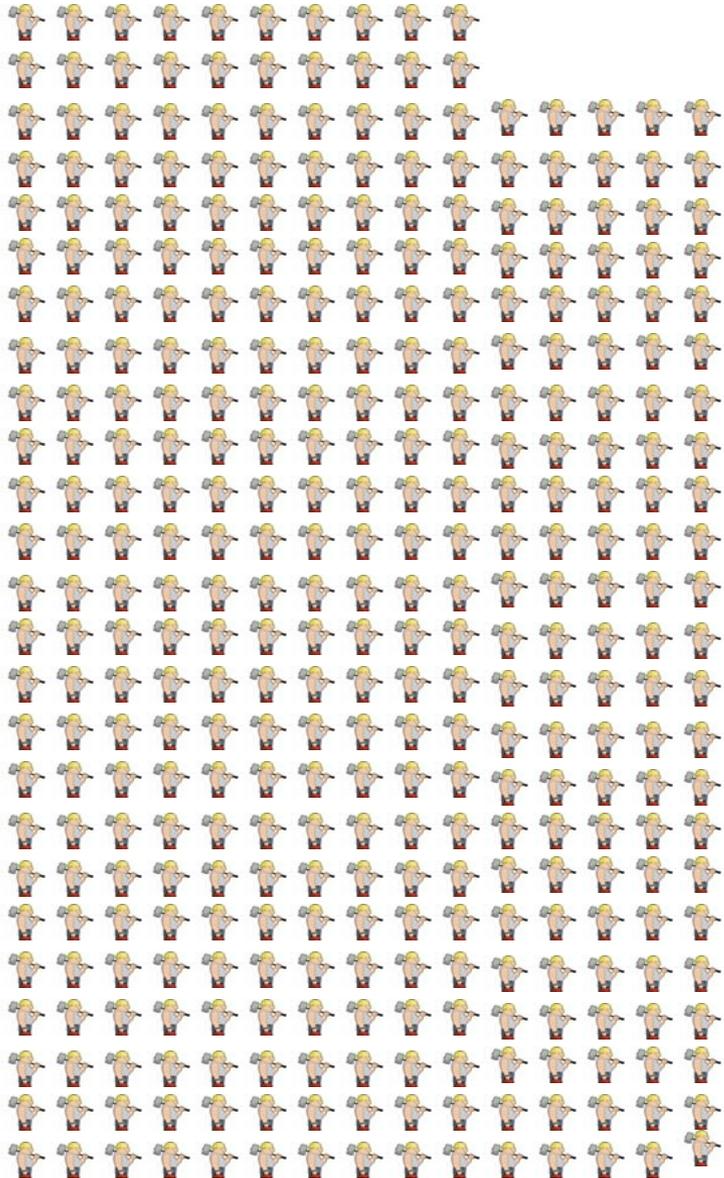
ANALYSIS OF PUBLIC ENEMIES PRODUCTION



The direct benefits rebounding to Wisconsin from Public Enemies were virtually offset by the expense

Source: Commerce data

It Takes A Lot of Workers to Pay for One Director



365



=

1



It takes 365 Wisconsin residents, working for 1 year, to generate enough income tax revenue to subsidize 1 Hollywood director who comes to Wisconsin to work for 2 months

Assumes Hollywood director makes \$2 million for 2 months; uses average wage 2007 data from BLS; uses effective tax rate of 3.6% from 2004 DOR tax incidence study

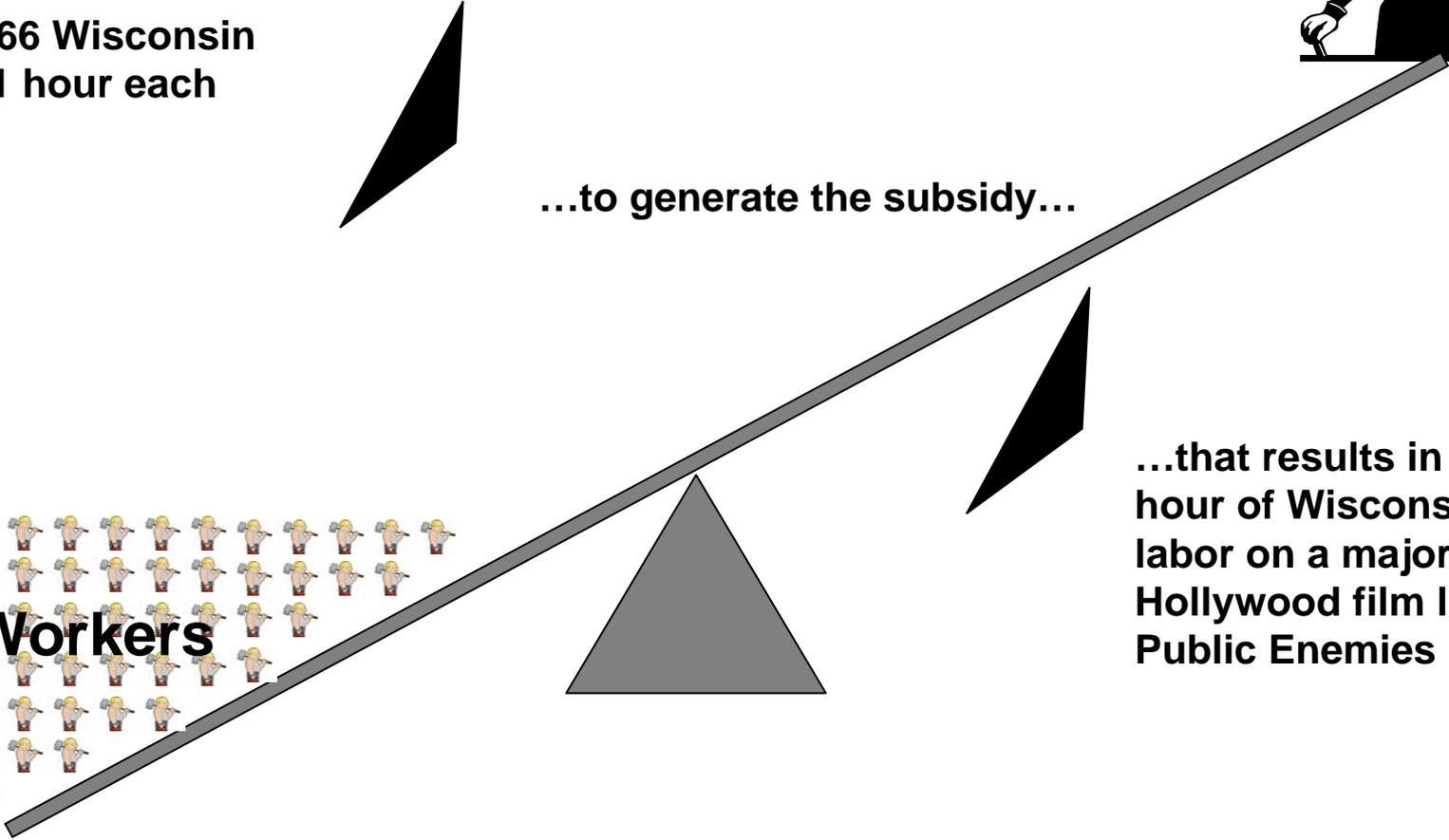
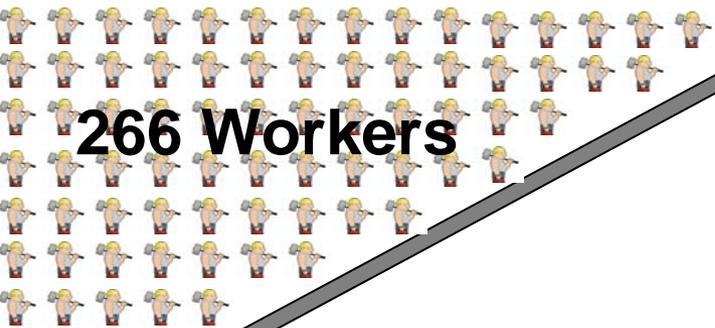
In Other Words...

It takes 266 Wisconsin workers 1 hour each



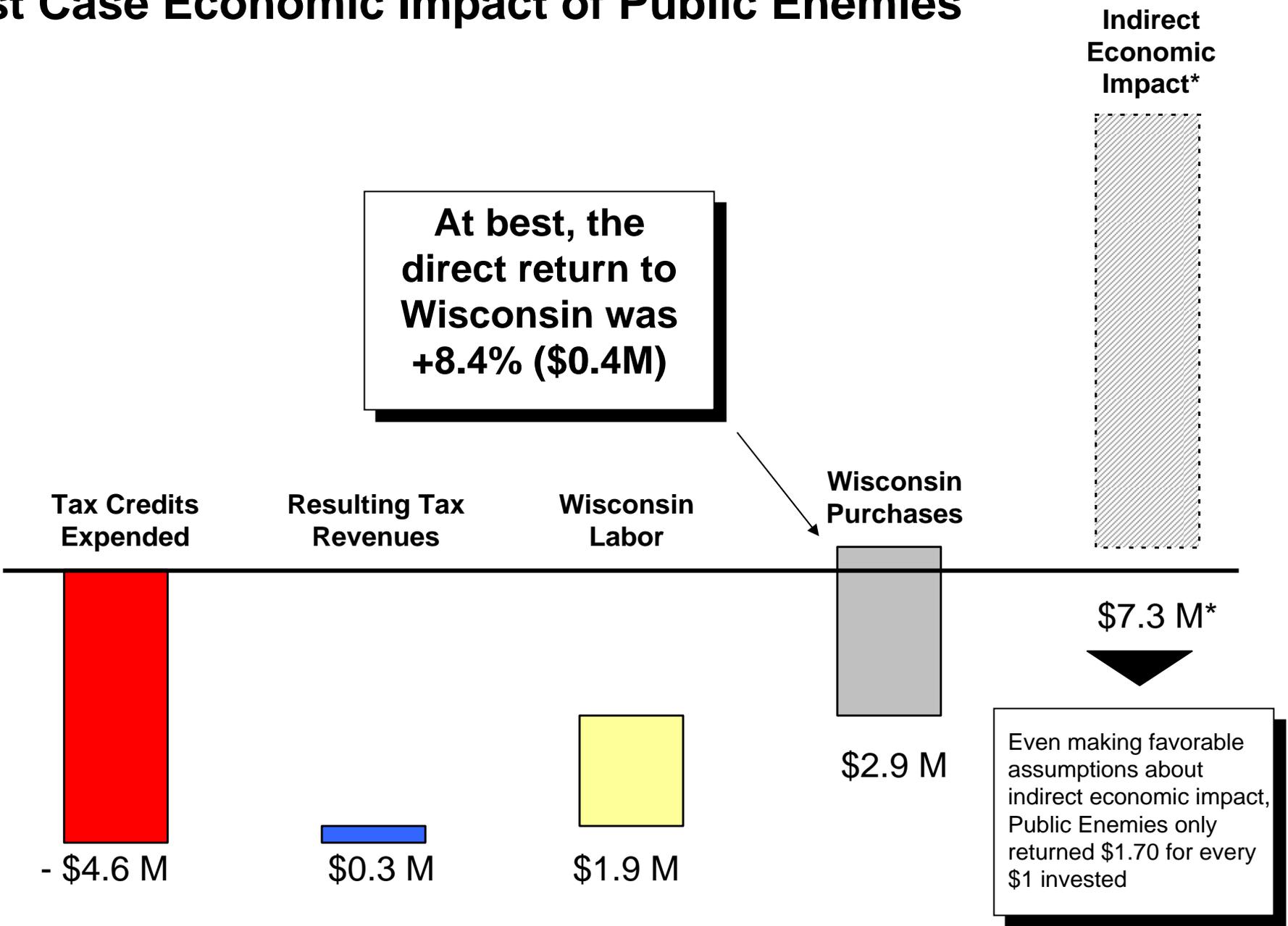
...to generate the subsidy...

...that results in 1 hour of Wisconsin labor on a major Hollywood film like Public Enemies



Source: Film Wisconsin Data on Public Enemies, BLS wage data, DOR tax incidence study, Commerce analysis

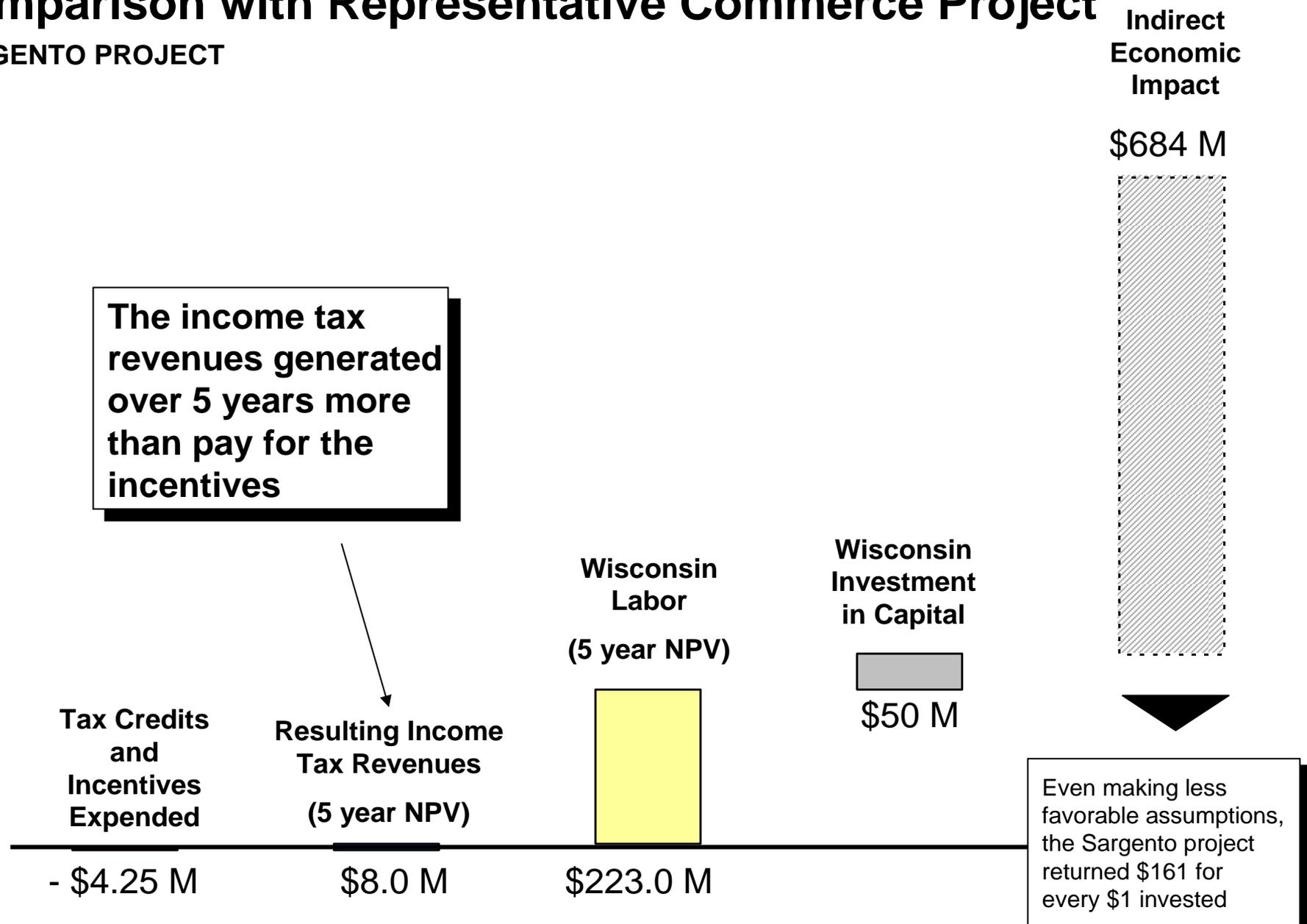
Best Case Economic Impact of Public Enemies



* Assumes 3.0 multiplier on all income; assumes 20% EBIT on purchases

Comparison with Representative Commerce Project

SARGENTO PROJECT



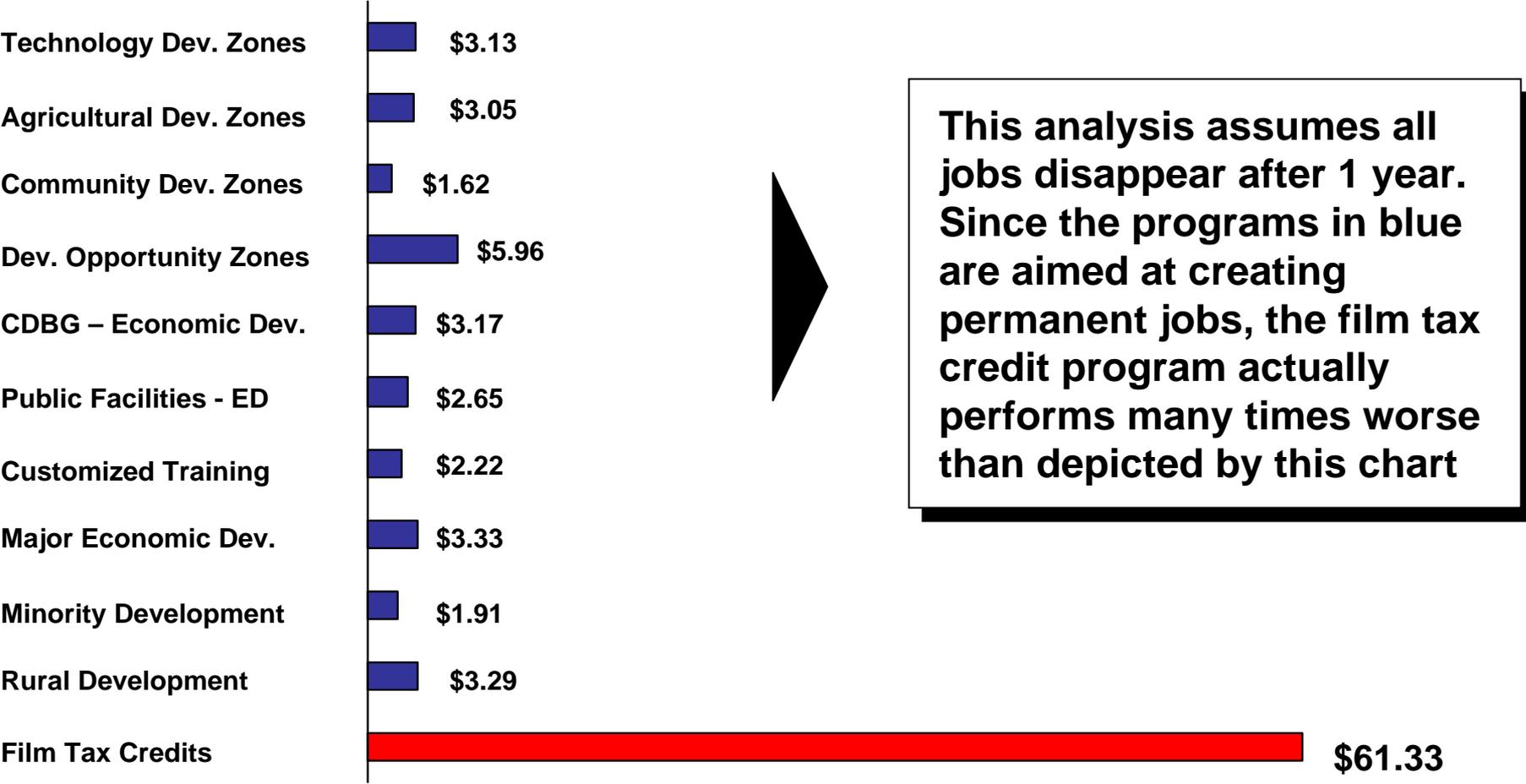
The income tax revenues generated over 5 years more than pay for the incentives

Even making less favorable assumptions, the Sargento project returned \$161 for every \$1 invested

Assumes 3.0 multiplier on all income; assumes 10% WI EBIT on capital expenditure, 3.6% effective tax rate, 1% annual raise, 10% discount rate

Film Tax Credits Not Effective For Job Creation

DOLLARS OF INCENTIVE PER HOUR OF EMPLOYMENT CREATED



Source: Commerce data, Film Wisconsin (Commerce used Film Wisconsin estimates of employment days generated)

Hollywood Films Are Even Less Effective Job Creators

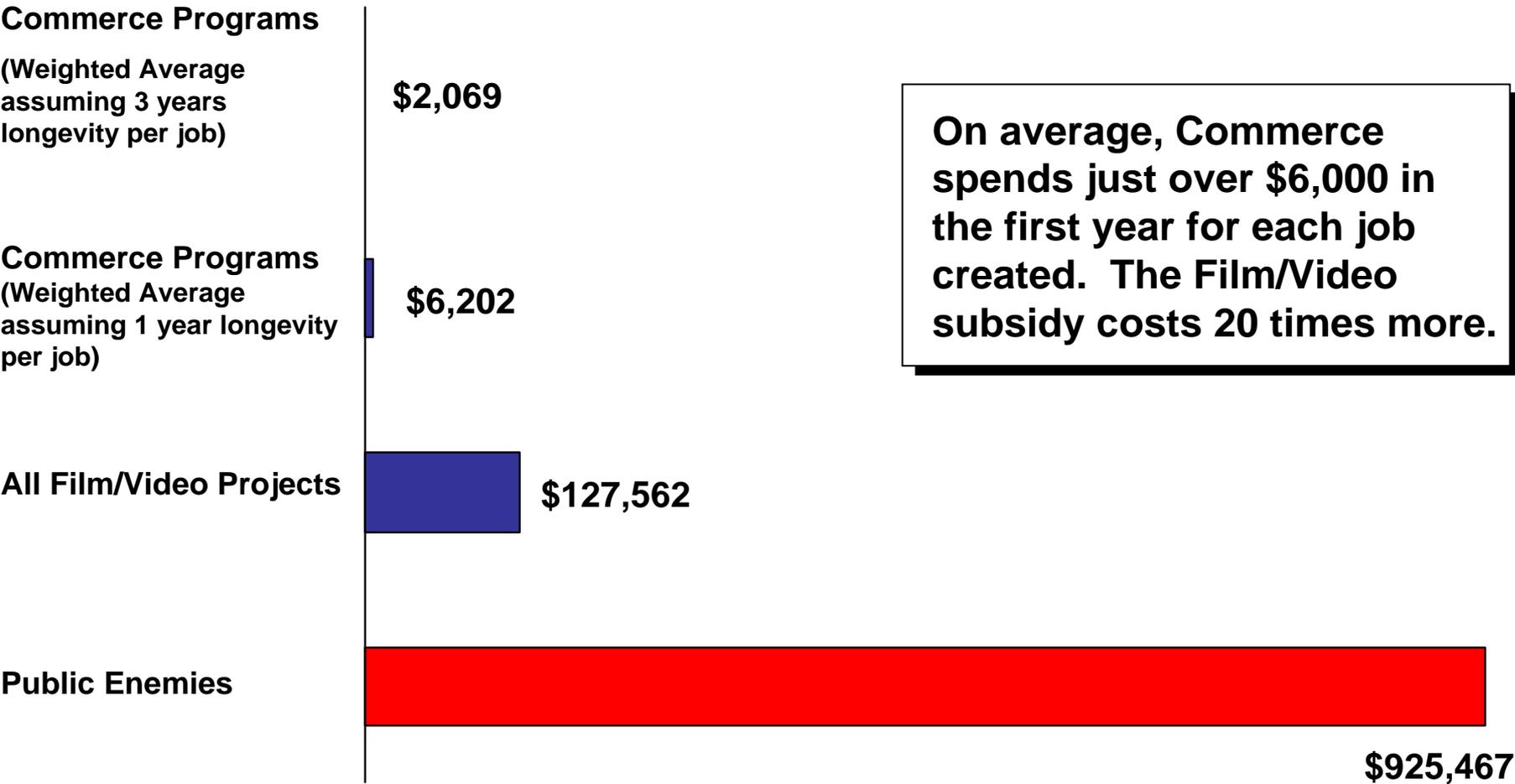
DOLLARS OF INCENTIVE PER HOUR OF EMPLOYMENT CREATED



Source: Commerce data, Film Wisconsin (Commerce used Film Wisconsin estimates of employment days generated)

Film Tax Credits Not Effective For Job Creation

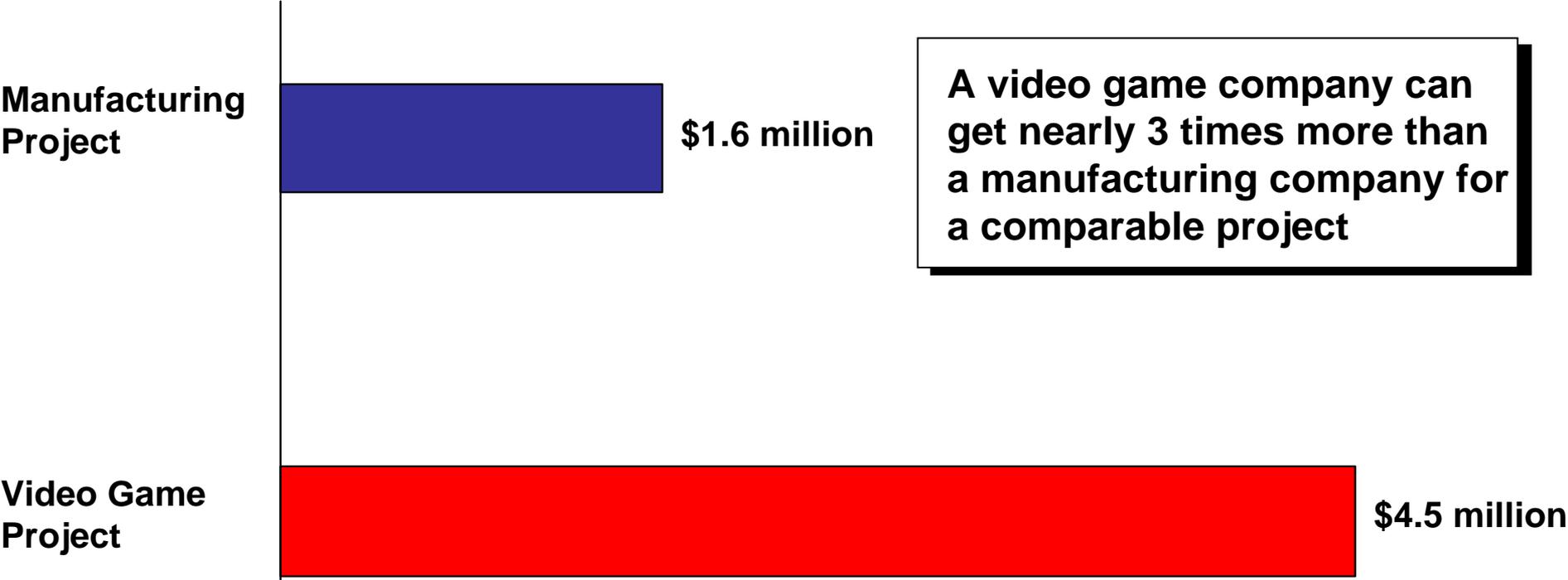
DOLLARS OF INCENTIVE PER JOB CREATED



Source: Commerce data (FY06 to present), Film Wisconsin (Commerce used Film Wisconsin estimates of employment days generated)

Flaw #5: The Program is Out of Line with Other Incentives

MAXIMUM INCENTIVE UNDER ENTERPRISE DEVELOPMENT ZONE AND FILM TAX CREDIT PROGRAMS

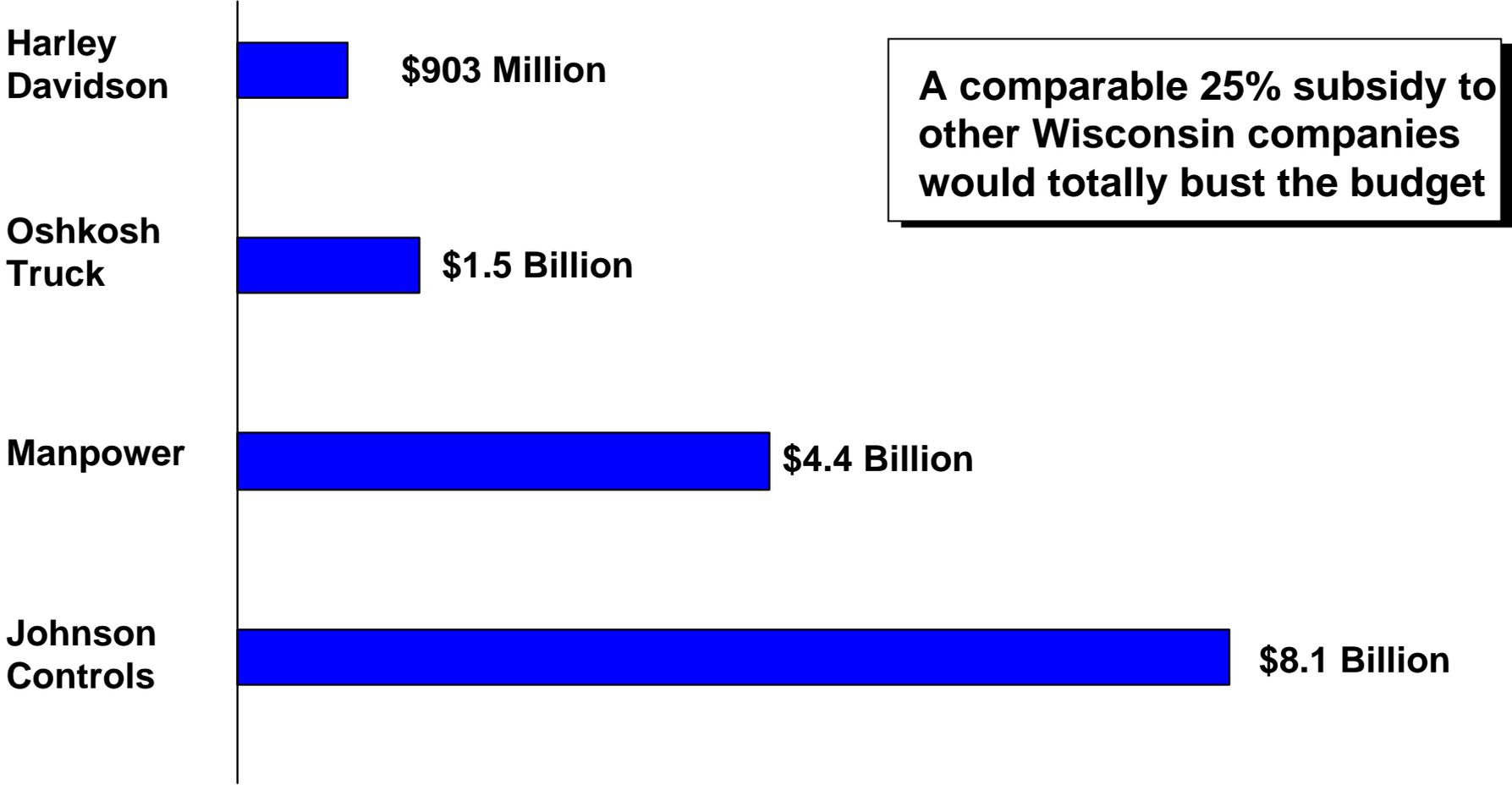


Project Assumptions

- Assumes both projects invest \$18 million
- Assumes both projects retain 180 jobs
- Assumes both projects create 20 new jobs

Cost to Provide “Film-Like” Incentives to Other Companies

POTENTIAL INCENTIVE EARNED BY PUBLICLY TRADED COMPANIES UNDER A SIMILAR PROGRAM



Source: Based on most recent annual report (2008; 2007 for Harley); 25% of Cost of Goods or Cost of Services

Flaw #6: Wisconsin's Program Has No Limits



Louisiana recently lost a law suit that will cost the state \$266 million in film tax credits

Wisconsin modeled our program on Louisiana's with refundable credits, a sum sufficient appropriation, and no limits

FILM TAX CREDITS ARE CONTROVERSIAL AROUND THE US

States' Film Production Incentives Cause Jitters

"Already on the hook for billions to bail out Wall Street, taxpayers are also finding themselves stuck with a growing tab for state programs intended to increase local film production. One of the most shocking bills has come due in Louisiana, where residents are financing a hefty share of Brad Pitt's next movie - \$27,117,737 to be exact..."

- The New York Times

Reviews for state's film tax credit aren't good

"The state gets back 28 cents for every dollar it gives up to the production companies, according to a recently released state Department of Revenue analysis. That's an investment return of negative 72 percent."

- The Providence Journal

FILM TAX CREDITS HEADLINES 2: THE SEQUEL

Hollywood East - How your tax dollars are subsidizing a film industry that doesn't need the help

"Mel Brooks once famously said, 'It will make millions. Unfortunately it will cost millions.' He was referencing one of his own films, but he could have been talking about film tax credits like the ones Connecticut offers production companies."

- The Hartford Advocate

Hollywood is here, but is price too high for state?

"The state provided \$2.65 million in tax credits to the production company that spent 26 days here filming Hard Luck, a feature film starring Wesley Snipes and Cybill Shepherd that went straight to DVD...But only \$1.9 million of the \$11 million went to 'Rhode Island vendors or residents,' according to the company's cost report."

- The Providence Journal

OTHER ANALYSES SUGGEST FILM CREDITS DON'T PAY OFF

“Film Tax Credits: Lower Taxes for Celebrities, Higher Taxes for You”

“There was a bit of insight from Producer John Boshier, when he told *Daily Tax Report* that the credit ‘gives us the ability to assuage investor concern by providing a guaranteed 15 to 20% return on their investment.’ – The Tax Foundation

Massachusetts: \$18.6 million in revenues, \$137.7 million in costs

“The [Department of Revenue Report] estimated that the total tax revenue forgone in 2006 to 2008 would be \$137.7 to \$138.7 million...Based on information provided on credit and sales tax applications, and the Massachusetts personal income tax rate of 5.3%, the Commonwealth could collect as much as \$18.6 million in new income taxes from motion picture productions...” - Massachusetts Budget and Policy Center

“Hollywood East? Film Tax Credits in New England”

“Consequently, film tax credits do not “pay for themselves” by indirectly generating additional corporate income, sales, and property tax revenues...in conclusion, the evidence available suggests that, while in some instances film tax credits have succeeded in attracting large increases in film production, they have also cost sponsoring states a good deal of foregone revenue.” - Federal Reserve Bank of Boston