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Issue Brief

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Reel Inefficiency

Why the Legislature Should Take Advantage of Sunset and Convert the Film Production Donation Tax Credit to a Direct Spending Program

If you could buy something directly for $90, would you pay a middleman $100 to buy it for you? Of course not; it would make no sense.

But that is, in essence, how Oregon subsidizes film production in the state. Through the Film Production Donation Tax Credit, Oregon pays $100 to a small, fortunate group of taxpayers for every $90 to $95 that they donate to a film production fund. The fund then subsidizes the filmmakers.

The inherent inefficiency in the current film production tax credit scheme — let alone the 167 percent expansion that the Governor is proposing — is one that the state can ill afford, as it faces a large revenue shortfall. If subsidizing in-state film production is a worthwhile use of taxpayer dollars, then the legislature should fund it directly out of the General Fund or Lottery Funds. With the tax credit program set to expire this year, this is an opportune time for the legislature to fix the inefficiency by changing the funding for the program from a tax credit to a direct appropriation.

The Film Production Subsidy Has Inefficiency Built into It

Like many states, Oregon subsidizes film and video production as a means to attract film production. Most states give the film and video producers tax breaks — credits against their tax liability or deductions that reduce taxable income.[1] Oregon, on the other hand, gives a direct subsidy for certain costs before taxes. The film producers apply to the Oregon Production Investment Fund ("film production fund," "film fund" or "film subsidy fund") for the subsidy. The film production fund managers believe this direct subsidy offers advantages over tax-based subsidies.[2]

Inefficiency, however, is built into the funding scheme. The film production fund gets its money to pay the subsidies through donations from "middlemen," and the donors get a $100 tax credit for every $90 to $95 they contribute, depending on the rate in effect at the time of the contribution.[3] The program has authority to issue up to $15 million in tax credits a biennium. If that $15 million maximum is reached and the tax credit-to-donation ratio is set at $100 for every $95 donated, then the film fund receives $14.25 million to subsidize the film and video industry and the donors pocket $750,000 as profit — a 5 percent gain.[4] If the ratio is set at $100 for every $90 donated, then the film fund's resources drop to $13.5 million and the donors' profit increases to $1.5 million — an 11 percent gain.[5]. Put another way, the fund is only 90 to 95 percent efficient in its use of taxpayer dollars.[6]

The Tax Credit Largely Benefits a Few Wealthy Taxpayers

Those who donate to the subsidy fund receive a guaranteed profit. The contributors get a 5 to 11 percent return on their donation to the subsidy pot, depending on the applicable tax-credit-to-donation ratio.[7] For those who can claim the tax credit in the current tax year, that guaranteed profit will be realized in less than a year's time.[8] For those who don't have enough tax liability to fully utilize the credits they purchased with their donation, they can carry forward their tax credits for three years.

By and large it is the wealthy who take advantage of the film tax credit scheme. Out of the approximately 1.6 million Oregon taxpayers in 2008, just 245 of them claimed the credit. Two-thirds of those claiming the credit – 161 of the 245 – belonged to the wealthiest 5 percent of taxpayers. Only 17 taxpayers who claimed the credit were from low- to middle-income households.[9] Those 161 taxpayers from the top 5 percent of the income scale reaped 87 percent of the tax credits claimed.[10]

Inefficiency Example:
Mark and Greg Goodman, Film Subsidy Middlemen
Who Made $94,000 from Oregon Taxpayers

Mark and Greg Goodman, prominent Portland businessmen, each contributed more than $427,000 to the film production fund in 2008, resulting in tax credits of over $475,000 for each of them. As a result, Oregon taxpayers paid each Goodman about $47,000 profit just for being the middlemen in funding the subsidy program.

Cutting out the Goodmans' credit and using a direct appropriation would have been more efficient. An appropriation of $854,000 in General Fund or Lottery Funds would have accomplished the same thing for the film industry while preserving about $94,000 for other public purposes.

If Subsidizing Film Production is Worthwhile, It Should be Funded Directly

There is good reason to question whether subsidizing film production makes economic sense for Oregon. Studies have found, for example, that state film subsidies are costly to states and generous to movie producers, that the best jobs go to non-residents, that many of the jobs created by film tax credits are temporary and part-time, that subsidies reward companies for production they might have done anyway, and that the subsidies don't pay for themselves.[11]

On the matter of whether the Oregon subsidy pays for itself, an economic analysis of Oregon's film and video industry commissioned by the Oregon Film and Video Office estimated that taxes paid by out-of-state film production economic activities were less than the total cost of the tax credit each year.[12] Therefore, even when assuming that the subsidy directly causes all activity by out-of-state film producers, the state tax and fee revenues generated can be expected to be less than the cost of the program to the state.

Setting aside questions of economic merit, there is no defensible justification for why the program should continue to be funded in an inefficient manner.[13] By appropriating funds directly from the General Fund or Lottery Funds, the legislature could still give film producers the exact same amount of money they are currently giving them while saving taxpayer money in the process. Getting rid of the tax credit funding mechanism simply means cutting out the profit that a few, mostly wealthy Oregon households receive.

More Spending Through the Tax Credit Would Exacerbate the Problem

Unfortunately, Governor John Kitzhaber has proposed expanding the problem in two ways. First, the Governor has proposed extending the "sunset" (expiration) of the program, currently set for December 31, 2011, for another six years, until December 31, 2017.[14] The longer the subsidy program is funded by tax credits rather than through an appropriation, the more taxpayer dollars its inefficiency will divert from other state priorities.

Second, the Governor has proposed more than doubling the cost of the film credit each biennium, thereby more than doubling the taxpayers' loss due to inefficiency. Specifically, legislation submitted by the Governor, HB 2167, would raise the ceiling on the total tax credit issuance from $15 million a biennium to $40 million a biennium — a 167 percent increase.[15] That increase would expand the inefficiency by an additional $1.25 million to $2.5 million per biennium. The increase would make the total revenues lost to profits between $2 and $4 million.

The Sunset Makes Converting the Funding to a Direct Appropriation Easy

Because the tax credit is set to expire at the end of this year, the current legislative session presents a good opportunity to eliminate the patent inefficiency in the funding mechanism for the film production subsidy. The legislature has the opportunity to fund the program through the appropriations process without having to vote to end the tax credit. The inefficient funding mechanism will die under its own sunset terms, unless the legislature chooses to continue the inefficiency.

Conclusion

With the state facing a large revenue shortfall that threatens public services that Oregonians count on, eliminating inefficient spending that occurs through the tax code must be a top priority. Unfortunately, the funding structure for subsidizing film production is one that has a built-in inefficiency. If subsidizing film production is worthwhile, then the legislature should fund it directly out of the General Fund or Lottery Funds and save money in the process by taking out the middlemen. Expanding the inefficient tax credit, as the Governor proposes, would only make the problem worse and further enrich a fortunate few at the expense of other state spending priorities. Fortunately, with the tax credit funding mechanism set to expire on its own, this legislative session is an opportune time to put an end to the inefficiency.

Endnotes:

[1] Robert Tannenwald, *State Film Subsidies: Not Much Bang For Too Many Bucks*, Center on Budget and Policy Priorities, December 9, 2010, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3326.

[2] The Film and Video Office tells prospective film producers, "Unlike other states' programs, these incentives are cash rebates as opposed to tax credits. This enables us to deliver you a check quickly and efficiently." See http://oregonfilm.org/incentives/.

[3] The legislature set a ceiling on the profit that can be reaped, while the agency set a floor. The state statute establishes that the donation cannot be smaller than 90 percent of the tax credit. ORS 315.514(2)(a). Thus, the statute sets the limit on how generous the tax credit can be. The agency rules, on the other hand, provide that the donation cannot be larger than 95 percent of the tax credit, thereby setting the minimum level of how generous the tax credit must be. The rules provide that the exact rate is calculated as 100 percent minus two times the two-year Treasury Notes rate but "never . . . more than 95% or less than 90%." OAR 951-003-0005(5).

[4] A $5 profit on a $95 dollar investment is a 5.3 percent gain ($100 tax credit divided by $95 donation cost = 1.053, or a 5.3 percent return on investment).

[5] A $10 profit on a $90 investment is an 11.1 percent gain ($100 tax credit divided by $90 donation cost = 1.111, or an 11.1 percent return on investment).

[6] There is some overhead for running the Film and Video Office and processing the requests for subsidies and making the subsidy payments, but presumably that is minimal and, more importantly, a fixed cost regardless of the source of funding for the film production fund.

[7] Under OAR 951-003-0005 the rate is recalculated every calendar quarter.

[8] On July 1,2010, in just 15 minutes the Film and Video Office sold $2.5 million in 2010 tax credits. See July 1, 2010 Oregon Film and Video Office post on Facebook. The donors realize the 5 percent profit embodied in those tax credits on their 2010 tax returns that they will file in 2011.

[9] This paper defines "low- and middle-income households" as the 60 percent of households that comprise the bottom three quintiles (fifths) of the income scale.

[10] OCPP analysis of 2008 Oregon tax return data provided by the Oregon Department of Revenue.

[11] Tannenwald, *State Film Subsidies*.

[12] Robert Whelan and Alec Josephson, *An Economic Impact Analysis of the Oregon Film and Video Industry in 2007, An analysis for the Oregon Film and Video Office*, ECONorthwest, July 29, 2008, available at http://oregonfilm.org/docs/ECONW-ORFilm-07.pdf.

[13] The argument that the tax credit provides certainty to film and video producers seeking multi-year funding commitment holds no sway and should be considered in context. An equally compelling argument can be made that than health care and long-term care providers, teachers, providers of early childhood education, public safety officers and the like who rely on state spending decisions also need certainty to be successful. Moreover, if the program is indeed effective it will continue to be funded biennium to biennium.

[14] See HB 2167 (introduced), available at http://www.leg.state.or.us/11reg/measpdf/hb2100.dir/hb2167.intro.pdf.

[15] Id. The Governor's budget proposal, available at http://governor.oregon.gov/Gov/docs/priorities/BUDGET_Full_Budget.pdf, states that the Governor wants to spend only an additional $10 million a year.

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