CONNECTICUT VOICES FOR CHILDREN

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Testimony Concerning:
HB 5585, An Act Concerning Digital and Film Media
HB 5509, An Act Concerning the Development of a Film Industry Curriculum
HB 5510, An Act Creating a Skilled Workforce for Connecticut's Film Industry

Shelley Geballe, JD, MPH
Higher Education and Employment Advancement Committee & Commerce Committee
February 26, 2008

Dear Senators LeBeau and Hartley, Representatives Berger and Willis, and distinguished Members of both Committees:

I am President of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth and families. Since 1997, CT Voices' work has included a focus on the state budget, looking not only at expenditures for the benefit of children and families, but also at how state revenues are collected, and what revenues the state decides not to collect through tax expenditures (tax credits, exemptions, deductions and rate increases that preferentially benefit a subset of taxpayers otherwise liable for a tax).

Earlier this month, CT Voices released a report that looked at Connecticut's business tax credits and was surprised to learn, in the course of researching that report, that the three "film" tax credits, together, are projected to result in a $116 million revenue loss next year, or more than a third the total revenue loss from *all* business tax credits. Given the size of the state's current, and relatively recent, investment in this industry through transferable tax credits (only one of which is capped), we began to look more closely at the "film" tax credits, and are releasing the first part of our report today. This report includes analysis of data in a report from the Connecticut Commission on Culture and Tourism to the Office of Policy and Management that I requested, and that OPM provided. An executive summary of this report is attached to this testimony. The full report is on our website, www.ctkidslink.org.

Based on my research, I strongly support the proposed requirement in Raised Bill 5585, section 1(b)(1) that the Commission provide monthly reports about the three film tax credits to the Commerce Committee. I urge, however, that the bill be amended to require reports, also, to the Finance, Revenue and Bonding Committee, given that the two uncapped credits can result in a continuing decline in corporate business and insurance premium tax revenues about which this Committee should be apprised.

I also support the proposals in each of the three raised bills to increase training opportunities for those interested in a career in the film and digital media industries. As Kevin Segalla, President of the Connecticut Film Center, LLC, testified before you last year:[1]

The film industry has really specialized positions in it. Being that Connecticut has not had the industry here, we haven't developed the workforce. Up to now we've really been bringing in a large majority of our crews from New York City, where they are living now.

Having a better-trained Connecticut workforce will keep more of Connecticut's investment in the entertainment industry *in* Connecticut.

However, I would strongly urge you also mandate a truly *independent* evaluation of the state's huge investment in the entertainment industry through these tax credits. As our report shows, these credits are resulting in an accelerating reduction in business tax revenues. Indeed:

- The FY 09 revenue loss projected by the Office of Fiscal Analysis through the three credits ($116 million) is equal to one-third of the total corporation business tax revenues OFA projects in FY 09 ($722.0 million). It also is double Connecticut's investment through tax credits in historic rehabilitation (both housing and mixed use); more than five times greater than the state's total investment through tax credits in research and development and research and experimentation; and more than ten times greater than Connecticut's investment in job creation tax credits.

- The projected $116 million FY 09 revenue loss from these entertainment-related tax credits also: is more than three times greater than the total FY 09 budget of the Department of Economic and Community Development; exceeds, by $21 million, the total FY 09 bond funding commitment to the Connecticut State University System's 2020 infrastructure project; is more than eleven times greater than the $10 million appropriated in FY 09 for grants for stem cell research; and is more than five times greater than the $21.5 million FY 09 funding increase approved last Session to expand school readiness to 4,100 additional children.

Further, the tax credits may not be as well-targeted as intended, or as is fiscally-responsible. For example, Connecticut is underwriting 30% of the costs of producing commercials and infomercials, and appears to be subsidizing some pre-existing activity by Connecticut companies as well.

With a slowing economy, the erosion of state revenues should be a concern of all. In addition, it is clear that *other* industries -- like nano-technology, "green" technologies, and biotechnology -- also could benefit from some state support. So it seems imperative that there be an *independent* evaluation of these tax credits. Such a review should include, among other things, an *independent* analysis of the extent to which the tax credits actually are "paying for themselves," ways in which the credits could be better targeted (e.g., to avoid subsidizing activity not originally targeted and providing more incentive than is needed to induce the desired response),[2] the most strategic ways to limit in *some* way the state's current open-ended financial exposure, and a candid assessment of the opportunity cost of the three tax credits.

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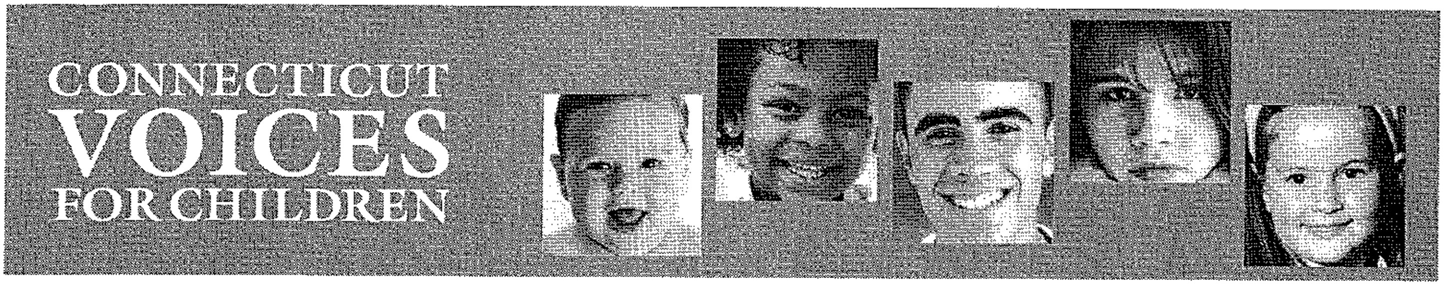
[1] Testimony of Kevin Segalla to the Commerce Committee on HB 6500, An Act Expanding Connecticut's Film Industry (March 7, 2007).

[2] Saas, *Hollywood East? Film Tax Credits in New England* (New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006), p.4.



Starstruck?
Connecticut's Block-Busting Spending on Entertainment Industry Tax Credits[1]
Part 1: The Credits and Who is Claiming Them

Shelley Geballe, JD, MPH

February 2008

"It's free money."
Andrew Gernhard (Hamden, CT producer)[2]

EXECUTIVE SUMMARY

In just two years, Connecticut has emerged as "the most generous state in the country for filmmakers"[3] due to its 30% transferable "film production" tax credit. Since enactment of this credit in 2006, Connecticut has created two other transferable credits – for "infrastructure" and for "digital animation production" -- and has expanded the scope of the "film production" tax credit, as well.

Already, Connecticut's tax credit-based investment in its entertainment industry far surpasses comparable investment in any other Connecticut industry or business activity, as illustrated in Table 1 below. Indeed, the projected $116 million FY 09 revenue loss from the three new "film" tax credits is *more than one-third* the projected FY 09 revenue loss from *all* business tax credits *combined.*

FY 09 Business Tax Credits	Projected FY 09 Revenue Loss (in millions)	% of projected FY 09 tax credits total value
Film (Production, Infrastructure, Digital Animation)	$116.0	34.3%
Fixed capital	$60.0	17.7%
Historic rehabilitation (homes, mixed use)	$51.2	15.2%
Electronic data processing	$40.0	11.8%
Job creation	$12.0	3.5%
Research and experimentation	$10.0	3.0%
Sale of tax credits	$7.5	2.2%
Housing program contribution	$6.5	1.9%
Displaced worker	$6.0	1.8%
Insurance reinvestment	$5.5	1.6%
Research and development	$5.0	1.5%
Machinery and equipment	$2.5	0.7%
Human capital	$2.5	0.7%
Neighborhood assistance	$2.5	0.7%
Remaining 20 credits (total)	$11.1	3.3%

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FY 09 Business Tax Credits	Projected FY 09 Revenue Loss (in millions)	% of projected FY 09 tax credits total value
TOTAL	$338.3	100.0%
Source: Office of Fiscal Analysis, *FY 08-FY 12 General Fund and Transportation Fund Budget Projections and Fiscal Information* (November 15, 2007), pp. 27-29.		

TABLE 1

This raises an obvious question. Is Connecticut getting the best return on its economic development investment by putting such emphasis on this industry?

This first part of CT Voices' report on Connecticut's three entertainment-related tax credits begins to explore this question in two ways. First, it reviews the design features of the three credits that make them quite unique among Connecticut's business tax credits. Second, it analyzes data provided by the Connecticut Commission on Culture and Tourism (CCT) to the Office of Policy and Management about the production companies that have claimed "film production" tax credits, or have claims for such credits pending, as of February 6, 2008, providing some insight into which companies are benefiting from these credits and for what types of activities.

Key findings from the report include:

- The "film production" tax credit, equal to 30% of all "qualified" production expenses or costs (over $50,000), provides tax credits not only for the production of feature films, but also television shows, commercials, infomercials, digital media, and videogames. Just half of the 58 "productions" currently claiming tax credits are feature films. Eligible production expenses are broadly defined to include duplication and distribution expenses, as well as production costs, with only one numerical restriction on allowable expenses. Tax credits cannot be awarded for compensation paid to any individual in a production *that exceeds* $15 million (i.e., if two actors receive exactly $15 million each to appear in a commercial made in Connecticut, the production company could claim $9 million in tax credits to offset this expense).
    - Although enacted to attract new business activity to Connecticut, some of the "film production" credits may be subsidizing Connecticut businesses for existing activities. World Wrestling Entertainment, Inc., a Connecticut-based company, estimates $9.3 million in Connecticut expenses in 2007 (that could result in $2.8 million in tax credits) for its SmackDown! and RAW television shows, though both shows have been on the air since 2005.[4] Anthem Blue Cross and Blue Shield estimates $279,300 in expenses for making an Anthem BlueCare Family Plan commercial. (Both credit claims are still pending.)
    - It not clear how much of the money spent in Connecticut on productions that are eligible for the tax credits actually remains in Connecticut. Crews imported from New York to staff productions take their much of their earnings back with them when the production ends, as do out-of-state vendors who come to Connecticut just for the days of the production itself.

- The "digital animation" tax credit, also equal to 30% of eligible production expenses (over $50,000) is defined broadly to provide tax credits for the creation, development, and production in Connecticut of computer-generated animation content, including production and post-production costs, duplication and distribution costs, and costs to purchase or option intellectual property (e.g., books, scripts, etc.). This credit has more restrictions than the "film production" credit on which companies are eligible for credits: they must be engaged exclusively in digital production; maintain digital production facilities in the state; and employ at least 200 full-time Connecticut workers.

- The "film infrastructure" tax credit is available to offset capital expenditures, project development expenses, and equipment expenses relating to the provision of buildings and facilities to be used for the production of multiple forms of entertainment in Connecticut. The credit amount is based on the project's costs; a 20% credit is provided if the costs of the infrastructure project exceed $1 million.

- All three tax credits can be used to reduce corporation business tax and insurance premiums tax liability. However, a company that claims the credits need not be a corporation or insurance company that is liable for these taxes. In fact, three-quarters of the production companies now claiming "film production" credits are Limited Liability Companies (LLCs). LLCs are *not* required to pay the corporation business tax, but pay a $250/year business entity tax for the privilege of doing business in Connecticut.

- Companies that cannot use the "film" tax credits to offset their *own* Connecticut tax liability can *sell* the credits to corporations or insurance companies with Connecticut tax liability to offset; these companies need have *no* relationship to the entertainment industry. So far, in fact, a total of $8.28 million in "film production" tax credits already have been transferred to a bank, a department store chain, and a manufacturer.

- Of the three credits, only the "digital animation production" tax credit is capped in any way. There is *no limit* on the amount of "film production" or "infrastructure" credits that can be claimed in a fiscal year either by production (e.g., a maximum of $10 million in credits per production) or in total (e.g., a maximum of $100 million in "film production" tax credits per year). The "digital animated production" tax credit is capped at $15 million in credits per state fiscal year. The fact that two of the tax credits are "uncapped" means that there is no fixed upper limit to the revenues Connecticut might lose on account of the credits.

- The FY 09 revenue loss projected by the Office of Fiscal Analysis through the three credits ($116 million) is equal to one-third of the total corporation business tax revenues OFA projects in FY 09 ($722.0 million). It also is double Connecticut's investment through tax credits in historic rehabilitation (both housing and mixed use); more than five times greater than the state's total investment through tax credits in research and development and research and experimentation; and more than ten times Connecticut's investment in job creation tax credits.

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- To date, there has been no *independent* evaluation to determine if these tax credits pay for themselves through increased income, sales and other tax revenues. However, a 2006 Policy Brief from the New England Policy Center at the Federal Reserve Bank of Boston, *Hollywood East: Film Tax Credits in New England,* finds that "film production stimulates little additional economic activity in other industries. Consequently, film tax credits do not 'pay for themselves' by indirectly generating additional corporate income, sales, and property tax revenues."[5]

- To date, there has been no *independent* evaluation to assess if this substantial investment in the entertainment industry provides the best return on Connecticut's substantial investment. Might $116 million in tax credits in some *other* industry or industries (e.g., nanotechnology, biotechnology, "green" technologies) result in more permanent, full-time, and higher quality jobs, and also greater direct, indirect, and induced economic activity?

With Connecticut's economy weakening, the report takes the position that our state's policymakers cannot afford to be "star-struck."

Connecticut's current open-ended "spending" through transferable tax credits to encourage growth in Connecticut's entertainment industry minimally should not evade the review that would be given an expenditure of this magnitude if, for example, the production companies instead received grants from the Connecticut Department of Economic and Community Development.

Such a review should include, among other things, an *independent* analysis of the extent to which the tax credits actually are "paying for themselves," ways in which the credits could be better targeted (e.g., to avoid subsidizing activity not originally targeted and providing more incentive than is needed to induce the desired response),[6] the most strategic ways to limit in *some* way the state's current open-ended financial exposure, and a candid assessment of the opportunity cost of the three tax credits.

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[1] This reports follows a report released earlier this month that examined Connecticut's business tax credits collectively. See, S. Geballe, *Business Tax Credits: The Blank Check in Connecticut's Economic Development Portfolio?* (Connecticut Voices for Children, February 10, 2008).

[2] Andrew Gernhard, producer with Synthetic Cinema and Tripeg Studios, Hamden, CT, quoted in J. Cooper, Excitement Grows as Hollywood Sets up Camp Across the State, *New Haven Arts and Entertainment Weekly* (May 22, 2007).

[3] J. Alterio, Lights, Camera, Action: Filmmakers Favor Connecticut, States with Generous Tax Incentives, *The (Westchester, N.Y.) Journal News* (December 10, 2007), available at www.hartfordbusiness.com/news3930.html.

[4] See www.wwe.com/shows/smackdown/archive and www.wwe.com/shows/raw/archive.

[5] Saas, *Hollywood East? Film Tax Credits in New England* (New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006), p. 1.

[6] Saas, *Hollywood East? Film Tax Credits in New England* (New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006), p.4.