The Commonwealth of Massachusetts
Office of the Inspector General

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*Via Email*

The Honorable Michael J. Rodrigues, Chair
Senate Committee on Ways and Means
State House, Room 212
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Michael.Rodrigues@masenate.gov

The Honorable Aaron M. Michlewitz, Chair
House Committee on Ways and Means
State House, Room 243
Boston, MA 02133
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**Re: Massachusetts Film Tax Incentive Program Reforms in the Fiscal Year 2022 Budget**

As you begin the FY2022 budget Conference Committee, I write in strong support of the Senate's proposals to amend the film tax incentive program. As you know, the Office of the Inspector General (Office) has a broad mandate to prevent and detect fraud, waste and abuse in public spending. For years, my Office has recommended eliminating this program due to a lack of safeguards and minimal benefit to the Commonwealth. The film tax incentive program does not provide a significant benefit to the Commonwealth nor is it an appropriate use of public funds. If the film tax incentive program is extended, I urge the Conference Committee to accept the Senate's proposals to tighten the eligibility for the program. Furthermore, I highly recommend implementation of other parameters, including caps on incentives paid out and additional state oversight of the program to protect the state's investment.

First, the film tax incentive program benefits the film industry, not Massachusetts employees. A recent, peer-review study determined that Massachusetts is among the top five states with the highest tax expenditures for film production.[1] The Department of Revenue (DOR)

[1] M.G.L. c. 29 defines tax expenditures as state tax revenue foregone as a direct result of any general or special law which allows exemptions, deferrals, deductions from or credits against taxes imposed on income, businesses and corporations, financial institutions, insurance and sales but excluding revenue foregone as a direct result of any general or special law which allows a personal income tax exemption. New York, Louisiana, Georgia, Connecticut

calculates that the incentive costs the state $56-$80 million per year. Further, it costs the state $100,000 for each job created.[2] The same peer-reviewed study shows that the percent increase in jobs in Massachusetts was less than the percent increase in tax expenditures.[3] The Tax Expenditure Review Commission recently determined that the incentive program "is not the best use of the state's money."[4]

Under the state's film tax incentive program, companies are eligible for two types of incentives; payroll credit incentives and production expenses incentives. Both incentives may equal up to 25% of the total qualifying payroll and/or production expenses. The statute defines qualified payroll as actual payments made to employees as Massachusetts sources of income. A company may not include any payment made to an employee making over $1 million in its application for credit. In order to qualify for the payroll credit, production expenses must exceed $50,000 in Massachusetts. A taxpayer may qualify for the production expense credit if the in-state production expenses exceed 50% of the total production expenses or if it spent at least 50% of production days in Massachusetts.

My Office strongly endorses tightening the eligibility for the incentive program. These spending thresholds should be increased. Mandating production companies spend 75% of its total days filming or 75% of its total production expenses in Massachusetts is a modest yet necessary increase ensuring that the state benefits more directly. I highly recommend the Conference Committee accept sections 25 and 35 Senate 2465.

As you know, film tax incentives are refundable and transferable. Once a production company has satisfied its tax liabilities, the company may request a refund of 90% of unused credits. The incentive is also transferable, meaning that a production company may sell its tax credits to another taxpaying entity. According to DOR, production companies transfer 89% of credits to third party entities.[5] A policy that allows an intended recipient to transfer tax credits is not a worthwhile investment of public dollars. Therefore, my Office strongly endorses section 92 in the Senate budget to eliminate the transferability of film tax incentives, beginning in January 2022.

Proponents of the film tax incentive program point to job opportunity, increased tourism and a stimulated local economy. However, the benefits are not long-term. The above-mentioned study found that the increase in jobs in Massachusetts was less than the increase in tax expenditures.[6] Moreover, there is a difference between wages for in-state and out-of-state

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and Massachusetts account for 77% of film tax expenditures. Michael Thom, *Do State Corporate Tax Incentives Create Jobs, Quasi-experimental Evidence from the Entertainment Industry* 51 State and Local Government Review. 94 (2019) [hereinafter *Corporate Tax Incentives*].

[2] Department of Revenue, *Report on the Impact of Massachusetts Film Industry Tax Incentives through Calendar Year 2016* 29 (2020).

[3] Thom, *Corporate Tax Incentives, supra* note 1, at 99.

[4] Massachusetts Tax Expenditure Review Commission, *Biennial Report of the Tax Expenditure Review Commission* 88 (2021).

[5] Massachusetts Tax Expenditure Review Commission, *supra* note 4 at 87, 90.

[6] Thom, *Corporate Tax Incentives, supra* note 1, at 99.

employees. For example, the median wage for out-of-state employees was approximately $88,000 whereas the median wage for Massachusetts-based employees was $72,000.[7] It should also be noted that these wages are often short-term. Film productions typically last for three months or less.[8] In 18 states that offer a transferable tax credit, job growth in the industry increased by less than 1% each year.[9]

Even more troubling is the amount in wages paid to employees making over $1 million. Between 2006 and 2016, $624 million was paid to individuals earning over $1 million. The majority of these employees reside out of state. The Senate caps the salary of any employee at $1 million for the purposes of the incentive. I urge the conference committee to accept the Senate's recommendation.

Further, the program does not require production costs be incurred with a Massachusetts-based business. According to the DOR, 62% of eligible spending went to non-Massachusetts based residents and businesses.[10]

The film tax incentive program does not benefit the Commonwealth. Although other states have incentive programs, even those states with the highest tax expenditures use cost-saving parameters, including caps. Moreover, many states have concluded that the tax incentive program is not an effective use of public resources. Since 2009, 13 states have reduced or eliminated their programs. Therefore, assuming the program will continue in Massachusetts, new oversight mechanisms must be in place to protect the state's investment.

First, a cap must be implemented on incentives paid out annually or by project. Other states, including California and New York have caps on their programs. Both of these states are among the top five states for film tax incentive expenditures.[11] Other Massachusetts tax incentive programs, including the Low-Income Housing and Historic Rehabilitation tax incentive programs have annual caps.

The state would also benefit if the Legislature increased the minimum amount a production company must spend in the Commonwealth to qualify for the incentive program. Massachusetts is one of four states that grant incentives when production spending is less than $75,000. There are 12 states that require spending at least $500,000 on production costs. Production companies must spend $1 million or more in California, Pennsylvania and Texas.[12]

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[7] Massachusetts Tax Expenditure Review Commission, *supra* note 4, at 97.
[8] Department of Revenue, *supra* note 2, at 21.
[9] Michael Thom, *Lights, Camera, but No Action? Tax and Economic Development Lessons from State Motion Picture Incentive Programs* 48 The American Review of Public Administration. 11 (2018).
[10] Department of Revenue, *supra* note 2, at 14.
[11] Thom, *Corporate Tax Incentives*, *supra* note 1, at 94.
[12] National Conference of State Legislatures, *State Film Production Incentives and Programs* (January 30, 2018). http://www.ncsl.org/research/fiscal-policy/state-film-production-incentives-and-programs.aspx.

Furthermore, an applicant should submit the tax credit application and documentation of its expenditures under the pains and penalties of perjury. The applicant should be required to retain all records relating to the film tax credit for at least seven years. The Office should have access to these records, and any relevant DOR records, for the purpose of independent verification. All documents, including tax returns, submitted during the two-step eligibility and certification process should be submitted directly to the Office for analysis. Many tax credit programs have few oversight mechanisms, and many have not been subject to significant review. Access to these documents allows the Office to uphold its mandate to prevent and detect fraud, waste and abuse. All submissions and findings related to film tax credits should be public documents.

Finally, no agency oversees the documentation submitted to receive the film tax incentive. Also, there is no audit of a production company's expenses before the credit is awarded. Without this oversight, the Commonwealth cannot be sure that the costs submitted are legitimate or that the film tax credit is justified in each case. A production company could report inflated expenses in order to receive a higher credit. That was the case when film director Daniel Adams submitted inflated costs to Massachusetts on two occasions in 2006 and 2009, defrauding the state of $4.7 million. The DOR discovered this inflation on a submission for the second production only because an actor complained that DOR was taxing him for income he had not been paid. He was subsequently sentenced to prison for larceny, false claims and tax fraud.

In closing, I strongly encourage the Conference Committee to accept the Senate's reforms to protect the state's investment. These reforms are an important step forward to strengthen the incentive program, however my Office will continue to advocate for additional reforms that directly benefit residents and the local economy.

Thank you for your consideration. If you have any questions, please do not hesitate to contact me.

Sincerely,

Glenn A. Cunha
Inspector General

cc: The Honorable Cindy F. Friedman
The Honorable Patrick M. O'Connor
The Honorable Ann-Margaret Ferrante
The Honorable Todd M. Smola