The Commonwealth of Massachusetts
Office of the Inspector General

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The Honorable Brian Dempsey, Chairman
House Committee on Ways and Means
State House, Room 243
Boston, MA 02133

The Honorable Karen Spilka, Chairwoman
Senate Committee on Ways and Means
State House, Room 212
Boston, MA 02133

Re: FY2018 Budget Section: Film Tax Credits

Dear Chairman Dempsey and Chairwoman Spilka:

As you deliberate the FY18 budget, I respectfully request your consideration of changes to the film tax credit program that were adopted in the Senate budget.

Specifically, I urge the conference committee to include the Senate's outside sections 59, 60, 67 and 68 in the committee's final report. Imposing tighter restrictions for film tax credit eligibility is critical to protecting the Commonwealth's financial interests. The film tax credit program, enacted in 2005, was supposed to spur economic growth and create jobs. However, numerous studies point to the lackluster role the program has had on the Commonwealth's overall economic health. For this reason, and because the program is subject to fraud, waste and abuse, my Office has previously supported elimination of film tax credits. While outside sections 59, 60, 67 and 68 would not eliminate the tax credits, they would help achieve the program's original goal of supporting the state's economy.

Outside sections 60 and 68 would increase in-state spending and in-state filming requirements for companies to be eligible for film tax credits. Currently, companies are eligible for credits if 50 percent of their total expenditures are made in Massachusetts or they spend 50 percent of their total production time in the state. Under the proposal the Senate adopted, companies would have to make 75 percent of their total expenditures in Massachusetts or maintain 75 percent of their total production time in Massachusetts to be eligible for the program. Strengthening these requirements will help ensure that only those productions poised to bring real economic benefits to Massachusetts-based businesses and residents are eligible for the film tax credit program.

In December 2016, the Department of Revenue ("DOR") issued its *Report on the Impact of the Massachusetts Film Industry Tax Incentives through Calendar Year 2014*, which found that between 2006 and 2014, the Commonwealth awarded approximately $548.1 million in tax credits for 1,110 productions. The DOR also found, however, that the majority of the credit-eligible expenditures made in Massachusetts were not paid to Massachusetts businesses or residents. Since the inception of the program, spending that was eligible for tax credits has been $2.2 billion. Of that, $802.5 million (36%) was paid to Massachusetts residents and Massachusetts-based businesses, while $1.4 billion (64%) was paid to non-residents and non-Massachusetts businesses.

Further, DOR estimates that between 2006 and 2014, third-party brokers accrued $9.5 million in gross profits by purchasing and re-selling film tax credits. Most production companies do not pay taxes in Massachusetts and therefore sell their tax credits directly to third-party brokers or to companies that pay Massachusetts taxes. The production companies typically receive less than the full value of the credits that they received from the state. In the case of third-party brokers, they then sell the tax credits to entities that have Massachusetts tax liabilities. Re-selling tax credits contradicts the intent of the program, which is to bolster the Massachusetts economy and provide jobs for residents.

Therefore, increasing the in-state spending and in-state filming requirements would be a positive step toward achieving the program's original goal. To further ensure that the program supports the state's economy, the conference committee could include a requirement directly linking the tax credit to expenses paid to Massachusetts businesses and residents.

Additionally, outside sections 59 and 67 would exclude any individual salary of $1,000,000 or more from the calculation of production expenses or productions costs. Frequently, the salaries of highly paid actors skew the overall expenses and production costs. In 2014, DOR calculated that $254 million was spent on new film productions in Massachusetts. Of that, $58.2 million went to individuals paid over $1,000,000. Further, the individuals receiving these salaries typically do not live in – or spend their salaries in – Massachusetts. Capping the amount companies can claim for salaries therefore would reduce the Commonwealth's liability for tax credits that do not support Massachusetts' economy.

Finally, as you deliberate the film tax credit program, I urge you to consider adopting strong oversight provisions. Not only is the program a financial burden for the Commonwealth, the state lacks the proper fraud prevention mechanisms that any tax incentive program should have. A 2017 Pew Foundation Report, *How States are Improving Tax Incentives for Jobs and Growth,* placed Massachusetts in the bottom tier with respect to oversight, based on the state's reluctance to evaluate the myriad tax incentives the Commonwealth offers. DOR annually evaluates and reports on the economic impact of the film tax credit program. However, current law does not mandate any agency to oversee the program, including validating the costs and expenses claimed in support of the tax credits. Without such oversight, the Commonwealth puts itself at risk of fraud and abuse in the program.

The film tax credit program is an unwise investment that has yet to prove any significant value to the Commonwealth. In times of fiscal uncertainty, it is imperative that we find robust solutions to effectively spend and manage taxpayer dollars. The outside sections in the Senate's budget provide important limits to ensure tax credits are allocated properly and for the benefit of the state.

Thank you for your attention to this matter. I appreciate your consideration of the Senate's proposal. Please do not hesitate to contact me if you have any questions.

Sincerely,

Glenn A. Cunha
Inspector General

cc: The Honorable Stephen Kulik
The Honorable Todd Smola
The Honorable Sal DiDomenico
The Honorable Viriato deMacedo