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Hollywood on the Bayou: An Optimal Tax Approach to Evaluating and Reforming the Louisiana Motion Picture Investor Tax Credit

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INTRODUCTION

As Louisiana experiences record-setting growth in the film industry, awareness of the Louisiana Motion Picture Investor Tax Credit (MPITC)[1] is more widespread than ever.[2] In 1992, Louisiana was the first state to roll out a major film subsidy program.[3] Then in 2002, the Louisiana Legislature set out to "encourage development in Louisiana of a strong capital and infrastructure base for motion picture production in order to achieve an independent, self-supporting industry."[4] Since the advent of the Louisiana MPITC, Louisiana has steadily gained recognition as a new hub for the film and television industry.[5] In 2011, a record 150 productions applied for the film tax credits.[6] For the productions that qualify, the incentives are significant: a 30% tax credit for spending at least $300,000 on productions filmed in Louisiana.[7]

The MPITC has benefited the State of Louisiana considerably. Between 2008 and 2010, the annual volume of films produced in Louisiana increased by 175%.[8] In 2010, the Louisiana film industry

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1. For the duration of this Comment, the Louisiana Motion Picture Investor Tax Credit will be referred to as MPITC.

2. The recent record-setting growth in Louisiana film production was largely expected in part because of the increase in highly publicized films since the Legislature's enactment of filmmaking tax incentives. *See* Mike Scott, *Louisiana Film Industry Passes Billion-Dollar Mark in Record-Setting 2011*, THE TIMES-PICAYUNE (Jan. 7, 2012, 5:00 AM), http://www.nola.com/movies/index.ssf /2012/01/louisiana _film_industry_passes.html (noting that the Louisiana film industry's growth should come as no "surprise to anybody who's been paying attention over the past decade" because of the consistent increase in major studio films shot in Louisiana).

3. TIM MATHIS, LOUISIANA FILM TAX CREDITS: COSTLY GIVEAWAY TO HOLLYWOOD, LOUISIANA BUDGET PROJECT (Aug. 2012), http://www.labudget.org /lbp/wp-content/uploads/2012/08/LBP-Report.Louisiana-Film-Tax-Credits.pdf.

4. LA. REV. STAT. ANN. § 47:6007 (2009) (amended 2013).

5. Richard A. Webster, *Year in Review: Hollywood South Sets New Records*, NEW ORLEANS CITY BUS. (Dec. 30, 2011, 2:51 PM), http://neworleans citybusiness.com/blog/2011/12/30/year-in-review-hollywood-south-sets-new-records.

6. *Id.*

7. § 47:6007(C)(1)(c)(i).

8. CHERYL LOUISE BAXTER, FISCAL & ECONOMIC IMPACT ANALYSIS OF LOUISIANA'S ENTERTAINMENT INCENTIVES (2011), *available at* http://louisiana entertainment.gov/docs/main/louisiana_entertainment_2011_economic_impact_an alysis.pdf.

became a billion-dollar player in the nationwide film market.[9] Louisiana is now ranked third in the country in film production activity, and the industry supports thousands of jobs in Louisiana that previously did not exist.[10] Additionally, motion picture production companies and their employees spend money that would not otherwise benefit Louisiana residents and businesses.[11]

Louisianans also enjoy the notoriety and excitement of living in "Hollywood South."[12] Some of the most highly publicized films released in 2012 took advantage of the MPITC. The popular *Twilight Saga: Breaking Dawn*, *Parts I and II* directly contributed \$189.3 million in economic activity in Louisiana while earning \$33.2 million in tax credits.[13] This translates to approximately \$5.70 in direct economic activity generated for every \$1 of state tax credits awarded.[14] Meanwhile, *Abraham Lincoln: Vampire Hunter* resulted in \$61.5 million in contributed economic activity and earned \$19.3 million in tax credits,[15] which translates to approximately \$3.19 in direct economic activity for every \$1 in state tax credits awarded to the production.[16]

Unfortunately, these results do not tell the whole story. An economic analysis by BaxStarr Consulting Group showed that motion picture production generated \$27 million in state tax revenue in 2010 while the State certified \$196.8 million in tax credits.[17] This figure indicates that the State is paying roughly \$7.29 per every \$1 it collects as a result of the MPITC.[18] The State of Louisiana is losing

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9. Scott, *supra* note 2.

10. Adriana Lopez, *A New Economic Report Surfaces*, *but It Could Have a Hollywood South Ending*, FORBES (Aug. 10, 2012, 12:58 PM), http://www.forbes.com/sites/adrianalopez/2012/08/10/a-new-economic-report-surfaces-but-it-could-have-a-hollywood-south-ending.

11. John Grand, *Motion Picture Tax Incentives: There's No Business Like Show Business*, 39 STATE TAX NOTES 10 (2006), *available at* http://taxprof.typepad.com/taxprof_blog/files/2006-2997-1.pdf.

12. Matthew J. Bailey, *Hollywood South: Why Film Credits Are Good for Louisiana*, 48 STATE TAX NOTES 715 (2008), *available at* http://thelouisianawavestudio.com/pdfs/Tax_Analyst_LA_Film_Credits.pdf.

13. Michelle Millhollon, *Panel to Review Tax Incentives*, THE ADVOCATE (July 1, 2012) (on file with the *Louisiana Law Review*). These economic contributions include payroll, purchases, and other economic activity in Louisiana.

14. \$189.3 million/\$33.2 million = \$5.70 generated for every \$1 of state investment.

15. Millhollon, *supra* note 13.

16. \$61.5 million/\$19.3 million = \$3.19 generated for every \$1 state investment.

17. BAXTER, *supra* note 8.

18. \$196.8 million/\$27 million = \$7.29. *See also* Daryl G. Pupera, *Louisiana Department of Economic Development and Louisiana Department of Revenue Motion Picture Investor Tax Credit Program*, *Performance Audit*, LA. LEGIS.

money on the MPITC program at an alarmingly high rate, and the rapidly increasing number of applications from production companies wishing to utilize the program signifies even greater losses in the future.[19] Some claim the MPITC creates a so-called "corporate welfare," subsidizing wealthy movie producers at the cost of Louisiana taxpayers.[20] In the 2013 Louisiana Legislative Session alone, two amendments to the MPITC were proposed and one enacted.[21]Amid a hefty budget deficit, Louisiana is making huge cuts to higher education and healthcare, while certifying $231 million in funds to subsidize the Louisiana film industry in 2012 alone.[22] Thus, Louisiana's film subsides are adding to an already devastating budget shortfall.

The MPITC as a tax policy has gathered widespread support for the creation of industry and jobs but is simultaneously receiving heavy criticism for the high cost imposed on Louisiana taxpayers.[23] To properly analyze any tax policy, analytical models separate efficiency and equity concerns to gain the clearest view of the tax policy's effectiveness.[24] The "optimal taxation" approach, one such way to analyze a tax policy, seeks to find a tax configuration that minimizes the loss in economic efficiency due to taxation while still reflecting society's attitude toward equity.[25] Using the optimal tax

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AUDITOR (Apr. 24, 2013), http://app1.lla.la.gov/PublicReports.nsf/5A685258D794067E86257B57005B8D58/$FILE/00032357.pdf ("The result is a net [fiscal] cost to the state of $169.8 million for the calendar year 2010.").

19. -86.28% Return on Investment ("R.O.I.") where R.O.I. = (Gain from Investment – Cost of Investment)/Cost of Investment.

20. MATHIS, *supra* note 3.

21. H.B. 161, 2013 Leg., Reg. Sess. (La. 2013); Motion Picture Investor Tax Credit, S.B. 165, 2013 Leg., Reg. Sess. (La. 2013). Sen. Martiny's Senate Bill 165 was approved June 7, 2013.

22. John Maginnis, *Louisiana's Revenue Commission Looks for What Is Broken*, THE TIMES-PICAYUNE (Sept. 19, 2012, 8:49 AM), http://www.nola.com/opinions/index.ssf/2012/09/louisianas_revenue_commission.html. ("Lawmakers recognize that many of the existing 422 tax breaks do a lot of good, but they aren't sure which ones are not, or whether a fraction of the $6.8 billion total would not be better spent on health care and higher education. . . . Louisiana's generous motion picture tax credit, at $174 million in F[iscal] Y[ear] 11 and growing, has brought many productions and great industry exposure to the state, but, with some exceptions, has not resulted in the permanent jobs and capital investment earlier envisioned. But we are assured the pipeline of projects would quickly run dry without the state subsidy.").

23. *Id. See also* MATHIS, *supra* note 3; Bailey, *supra* note 12.

24. Patrick B. Crawford, *The Utility of the Efficiency/Equity Dichotomy in Tax Policy Analysis*, 16 VA. TAX REV. 501, 502 (1997).

25. Eric M. Zolt, *The Uneasy Case for Uniform Taxation*, 16 VA. TAX REV. 39, 42 (1996).

approach, this Comment suggests that although the MPITC may provide benefits to the State, it must be scaled back to increase the economic efficiency and increase equity in the treatment of taxpayers.

Part I of this Comment explains how the MPITC awards credits and how the resale market of those credits functions. Next, Part II examines the efficiency of the MPITC, evaluating the tax credit under three models of efficiency, which indicate the credit is overaggressive and hence inefficient. Part III then scrutinizes the inequities of the MPITC. Finally, Part IV proposes the following three alterations to the program: (1) a statutory annual cap on the MPITC; (2) a methodology for awarding those credits in an auction-like system; and (3) an explicitly limited definition of production expenditures. These alterations will make the MPITC both more efficient and more equitable by decreasing the size of the program.

I. HOW THE MOTION PICTURE INVESTOR TAX CREDIT IS DISTRIBUTED AND USED

The following discussion analyzes how Louisiana awards its tax credit and how that credit is then used by the production. Before credits are earned, the production must be state certified.[26] State certification has four components:

> (1) The relevant department in, and the secretary of, the Louisiana Office of Economic Development (LED) must approve the production.
> (2) The production must be domiciled and headquartered in Louisiana.
> (3) The production must have a viable multimarket commercial distribution plan.
> (4) The motion picture or television project must incur at least $300,000 of production expenditures.[27]

Once a production is state certified, the investor is allowed a tax credit of 30% of the base investment made by that investor.[28] The credits are awarded within 120 days of the receipt of the "production audit report" certifying that "the report of production expenditures presents fairly, in all material aspects, the production expenditures

26. LA. REV. STAT. ANN. § 47:6007 (2009) (amended 2013).
27. Jayne A. Calhoun, *Hooray for Hollywood! A Film-by-Film Primer on the Louisiana Film Industry's Blockbuster Success Thanks to Motion Picture Tax Incentives*, 58 LA. BAR JNL. 88, 90 (2010).
28. § 47:6007(B)(1). A "'[b]ase investment' means cash or cash equivalent investment made and used for production expenditures in the state for a state-certified production." *Id.*

expended in Louisiana pursuant to [the provisions of the MPITC]."[29]

The MPITC applies to a wide range of expenditures. The legislation has defined "production expenditures" as:

> [P]reproduction, production, and postproduction expenditures in this state directly relating to a state-certified production, including *without limitation* the following: set construction and operation; wardrobes, makeup, accessories, and related services; costs associated with photography and sound synchronization, lighting, and related services and materials; editing and related services; rental of facilities and equipment; leasing of vehicles; costs of food and lodging; digital or tape editing, film processing, transfer of film to tape or digital format, sound mixing, special and visual effects; and payroll. This term shall not include expenditures for marketing and distribution, non-production related overhead, amounts reimbursed by the state or any other governmental entity, costs related to the transfer of tax credits, amounts that are paid to persons or entities as a result of their participation in profits from the exploitation of the production, the application fee, or state or local taxes.[30]

This expansive definition contributes to a high volume of credits awarded under the MPITC because practically any expense can be argued to fit under it, particularly due to the "without limitation" language.[31]

Once the credits are awarded, they are applied after the total amount of tax liability due to the State is determined. Income taxes are only imposed on taxable income.[32] Taxable income refers to total taxable income minus deductions.[33] Taxable income is taxed at a rate determined by the amount of taxable income earned.[34] In Louisiana, this rate is 6% for those whose taxable income exceeds $50,000.[35] Applying this rate to the taxable income determines the

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29. Motion Picture Investor Tax Credit, S.B. 165, 2013 Leg., Reg. Sess. (La. 2013).

30. § 47:6007(B)(9) (emphasis added).

31. *Id.*

32. JAMES J. FREELAND ET AL., FUNDAMENTALS OF FEDERAL INCOME TAXATION 42 (15th ed. 2009). "Louisiana taxable income is computed by subtracting the federal income tax deductions allowed by [Louisiana Revised Statutes section] 47:287.85 from Louisiana net income, after adjustments." LA. REV. STAT. ANN. § 47:287.79 (2001).

33. FREELAND ET AL., *supra* note 32, at 42.

34. *Id.*

35. LA. REV. STAT. ANN. § 47:287.12(3) (2001). A single taxpayer earning more than $50,000 but not in excess of $100,000 dollars per year is taxed at 6%.

dollar amount of tax liability.[36] Credits can then be applied to this amount to reduce the overall obligation of the taxpayer.[37]

To illustrate how the MPITC works using a simple example, assume an investor expended the statutory minimum of $300,000 on a movie filmed in Louisiana.[38] Applying the MPITC's 30% credit, the investor thus receives a $90,000 tax credit for the $300,000 investment. Next, assume the movie earns $1 million, and the investor is not realistically eligible for any deductions.[39] The taxable income is $1 million, and this amount is taxed at 6%.[40] If the investor had Louisiana income tax liability, the investor would owe $60,000 to the State and could offset this by the $90,000 in earned credits.[41] Not only does the movie investor completely offset state tax liability, but the investor also has $30,000 in leftover credits.

Compare this to an investor in the production of an unsubsidized good in Louisiana. For instance, if an investor in widget production earns $1 million and also expends $300,000, state income tax liability would be approximately $60,000, or 6% of $1 million.[42] The MPITC paid the movie investor's state income tax liability and also paid the investor $30,000 in leftover credits, compared to the widget investor who had to pay the State the full $60,000 without any help from the State whatsoever. The movie investor would have $730,000 after-tax income, while the widget investor would have just $640,000.[43]

The rate increases to 8% on Louisiana taxable income in excess of $200,000 dollars.

36. FREELAND ET AL., *supra* note 32, at 43.

37. *Id.* at 43.

38. LA. REV. STAT. ANN. § 47:6007 (2009) (amended 2013).

39. FREELAND ET AL., *supra* note 32, at 323. Likely, almost any business actor would be eligible for at least some deductions. This is because expenses paid or incurred during the taxable year are deductible and almost all business actors have some expenses. However, for the sake of simplicity in the calculations, deductions are assumed to be zero.

40. *Id.* at 46–47 (Taxable income = Gross income – Expenses – Possible Deductions); LA. REV. STAT. ANN. § 47:287.12 (2001).

41. The taxable income in this case is $1 million, taxed at 6%, meaning this investor has a $60,000 state income tax liability. For simplicity, this model further assumes a flat tax rate, meaning all income earned will be taxed at the highest rate.

42. The assumption of no business deductions is again unrealistic, but for the ease of calculation deductions are assumed to be zero. Therefore, this investor is taxed at 6% on the full $1 million in income, assuming a flat tax rate. This creates the $60,000 state income tax liability.

43. The movie investor made $1 million, spent $300,000, but received $30,000 in income tax credits, while the widget investor made $1 million, spent $300,000, and received no assistance to pay state income tax liability.

Out-of-state producers drawn to Louisiana by the MPITC rarely have in-state tax liability, and even if they do, the value of the credits often far exceeds it, leaving the producers with leftover credits.[44] The manner in which Louisiana handles those leftover tax credits is one of the main sources of popularity of the program because production investors may transfer or sell unused credits.[45] When producers of films in Louisiana do not earn enough money in state to take full advantage of the tax credits, they can sell the credits back to the State or to entities that can use the credits themselves.[46] This process, which is referred to as "monetization," allows the producers to trade in their credits for cash.[47] The Louisiana Legislature has continued to support the MPITC's transferable nature, unequivocally preserving the transferability of the credits, despite calls for the disallowance of transfers.[48]

Though the MPITC explicitly allows those who were initially awarded the credits to sell them to any willing party, regardless of affiliation with the Louisiana film industry, the process is quite complex. As such, technical know-how is required to facilitate a transfer.[49] Tax credit brokerage firms—which specialize in monetization, certification, and the resale process—often assist film productions with this complex process.[50] They have relationships

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44. RUTE PINHO, MONETIZING FILM TAX CREDITS (2011), *available at* http://www.cga.ct.gov/2011/rpt/2011-R-0462.htm. These producers are required to file their state income tax in their home state, not Louisiana.

45. Calhoun, *supra* note 27.

46. LA. REV. STAT. ANN. § 47:6007(C)(4) (2009) (amended 2013).

47. PINHO, *supra* note 44.

48. H.B. 161, 2013 Leg., Reg. Sess. (La. 2013) (proposed legislation that would repeal the authority for the credit to be transferred or sold); Motion Picture Investor Tax Credit, S.B. 165, 2013 Leg., Reg. Sess. (La. 2013) (preserved transferability provisions as adopted by the Louisiana Legislature).

49. Louisiana Revised Statutes section 47:6007(C)(4) outlines the requirements for transferability including a $200 fee. Louisiana Revised Statutes section 47:6007(C)(4)(b) lays out the other requirements in pertinent part:

> Transferors and transferees shall submit to the office, and to the Department of Revenue in writing, a notification of any transfer or sale of tax credits within thirty days after the transfer or sale of such tax credits. The notification shall include the transferor's tax credit balance prior to transfer, a copy of any tax credit certification letter(s) issued by the office and the secretary of the Department of Economic Development and, the transferor's remaining tax credit balance after transfer, all tax identification numbers for both transferor and transferee, the date of transfer, the amount transferred, a copy of the credit certificate, price paid by the transferee to the transferor, in the case when the transferor is a state-certified production, for the tax credits, and any other information required by the office or the Department of Revenue.

§ 47:6007(C)(4)(b).

50. Bailey, *supra* note 12.

with the major production companies and often buy huge quantities of those companies' leftover credits at a discount. The brokers then go through accounting and business management firms to sell the credits to taxpayers with large in-state tax liability, who then apply the full value of the credits against their tax liability.[51]

Returning to the example of the minimum investor with $30,000 in leftover credits, the resale market would work as follows: The investor would work with a brokerage firm to apply, certify, and receive the credits. Then the brokerage firm would purchase the leftover credits for some price, say $0.80 on the dollar. The brokerage firm would work through the complicated transfer and pay the minimum investor $24,000 for his leftover credits. Next the brokerage firm would contact a purchaser—typically an accounting firm—that would resell the credits to its clients to offset its clients' tax liabilities.[52] Louisiana Economic Development (LED) typically places the resale value between $0.80 and $0.90 on the dollar.[53] Presume the minimum investor used a broker that sold the credits for $0.88 per credit; the broker would sell the credits to the purchaser for $26,400. The purchaser could then offset its client's Louisiana tax liability by the full value of the credits, $30,000. In this instance, the minimum investor made $24,000, the brokerage firm made $2,400, and the purchaser of the credits pocketed $3,600 in offset tax liability.[54]

However, the role of brokers in the MPITC is waning. The State dramatically altered the resale market in 2009 when the Legislature added Louisiana Revised Statutes section 47:6007(4)(f)(ii), which authorizes investors to sell directly back to the State for $0.85 on the dollar.[55] As a result, the brokers now must pay more than the state rate to remain competitive in the private resale market.

If a broker pays just over the state buyback value at $0.86 on the dollar, the broker's profit on the transaction with the minimum investor shrinks to $600.[56] Considering the $200 fee imposed by the State and the complexity of orchestrating transfers, the broker would

51. *Id.*
52. *Id.*
53. *Film FAQ*, LA. ECON. DEV., http://louisianaentertainment.gov/index.php/film/faq/incentive.
54. The original producer was not only able to offset all state income tax liability but also sold the credits to the broker for the cash equivalent of $24,000. Although the purchaser of the credits paid just $26,400, the purchaser is able to offset his Louisiana state income tax liability by the full amount of the credits, $30,000. Therefore, the purchaser was able to pocket the difference, $3,600.
55. LA. REV. STAT. ANN. § 47:6007 (2009).
56. The broker would purchase the credits for $25,800 and sell them for $26,400.

have little incentive to engage in this transfer.[57] Further, some production studios have become experts in the MPITC and the transfer requirements.[58] The studios then work directly with accounting firms to sell the credits and bypass the broker's markup.[59]

While preserving the transferability of the MPITC, the Legislature recently took steps to better regulate the transfer process by establishing a central tax credit registry that specifically addresses the resale markets.[60] The Louisiana Tax Credit Registry Act imposes notice requirements on both the transferor and the transferee and provides for increased oversight of the resale market by the Department of Revenue.[61] Despite these changes, brokerage firms still engage in MPITC transfers, but their role is increasingly shrinking due to the State's buyback program, the studios' growing expertise, and increased State oversight.

II. EFFICIENCIES: ELASTICITY, EXTERNALITY CONCERNS, AND KALDOR–HICKS

The standard analytical model used in tax policy separates efficiency and equity issues to determine the efficacy of a tax.[62] Efficiency is subject to different interpretations, and there are many conceptions of efficiency that can yield judgments of a tax policy.[63] However, it is important to note that these models make a number of assumptions, including the presence of rational actors and access to perfect information. While this often is not the case, these concepts still offer a valuable framework to make judgments about which tax policies are most efficient. Using three of these efficiency concepts, elasticity, externality concerns, and Kaldor–Hicks, it is evident that the subsidy Louisiana is providing to film producers in the MPITC is overaggressive and, therefore, inefficient.

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57. *See* § 47:6007(C)(4).

58. Celtic Media Centre, which is located in Baton Rouge, Louisiana, advertises on its website that The Celtic Group, owner of Celtic Media Centre, "can help productions find Louisiana buyers for tax credits who may be willing to pay better than $.85 on the dollar." *Tax Incentives*, CELTIC MEDIA CENTRE, www.celticmediacentre.com/filming_in_louisiana/tax_incentives.

59. *Id.*

60. Tax Credits, H.B. 377, 2013 Leg., Reg. Sess. (La. 2013).

61. *Id.*

62. Crawford, *supra* note 24, at 502.

63. Zolt, *supra* note 25, at 63.

A. Elasticity of Supply and Subsidies[64]

To be an efficient subsidy, the MPITC must have the power to draw film producers from out-of-state markets.[65] From an economics standpoint, price elasticity of supply is one way to predict producers' willingness to relocate based on the MPITC. Price elasticity is an economic measure used to show the responsiveness of film producers to price change.[66] The supply of a perfectly inelastic good will not change even with a significant price change, while the supply of relatively elastic good will change more significantly with price variation.[67] Therefore, for the MPITC to be efficient and actually draw new producers, the price elasticity of supply for film production must be relatively elastic so that the change in price draws producers. Unfortunately, deriving the actual elasticity of supply for most commodities is a difficult task.[68] However, looking at the factors affecting the elasticity of supply, it can be reasonably inferred that film production in Louisiana is relatively elastic.[69]

The primary factor that influences the elasticity of supply is the availability of inputs, or how readily accessible the needed items for

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64. This Section is derived from the idea of the Ramsey inverse-elasticity rule. *See generally* F.P. Ramsey, *A Contribution to the Theory of Taxation*, 37 ECON. J. 47 (1927). This rule states that the highest rate of taxes should be placed on those goods with the most relatively inelastic demand or supply. *Id.* The idea is that an efficient tax system will distort consumer and producer choice by the least amount possible. *Id.* Because an inelastic demand or supply means actors do not respond much to price change, placing a tax on those goods should not change their choices. *Id.* However, Ramsey, the economist who first derived this theory, did not believe in any subsidization, and therefore it would be incorrect to use the inverse-elasticity rule he first posited to justify a subsidy. *Id.*

65. For the Louisiana MPITC to really work, it would seem that it would need to attract out-of-state producers who would not have otherwise produced in Louisiana. In other words, the central idea of the MPITC is to increase the amount of money in Louisiana's economy rather than just increase the number of citizens making movies. There would seem to be little extra value in drawing Louisianans to film production, and this could even be harmful by creating an oversupply of filmmaking in Louisiana and an undersupply of other needed goods. If one analogizes Louisiana's economy to a pie, the goal is to grow the overall size of the pie, not to divvy it up differently. That is, the goal should be to attract new economic actors and their money rather than to encourage Louisianans to abandon unsubsidized industries to work in film production.

66. PAUL KRUGMAN, ROBIN WELLS & KATHRYN GRADDY, ESSENTIALS OF ECONOMICS 149 (Charles Linsmeler et al. eds., 3d ed. 2012) (stating that price elasticity of supply measures the response of producers to price changes.).

67. *Id.* at 150.

68. Zolt, *supra* note 25, at 67.

69. *See infra* text accompanying notes 70–79 (concluding that the relevant indicators suggest film production is relatively elastic).

production are.[70] California has the most readily available inputs for film production due to its infrastructure, trained workforce, and existing business base.[71] However, the MPITC has helped draw away significant numbers of productions.[72] When the MPITC makes film production cheap enough outside of California, producers will be incentivized to relocate and can do so thanks to the film industry's mobile nature.[73] Though the existing infrastructure in California and the costs of moving production decrease the film production industry's elasticity, the overall mobility of the industry allows producers to respond to changes in price with relative ease.[74]

Time is the second most important factor in determining the price elasticity of supply.[75] Generally, the longer any producer has to respond to price changes, the more relatively elastic supply will become because a longer timeframe allows a producer to make necessary changes to the current production to account for the price change.[76] For instance, a film producer needs time to research the MPITC and make the adjustments necessary to take advantage of it.

Generally, film productions are short-term projects that allow little time for adjustments.[77] Within productions, because of the expediency of shoots, the production location is likely fixed, making it difficult for the producer to respond to price changes during the production of one film. However, because individual productions wrap up fairly quickly, when a producer learns of a price change, there is time to respond by changing the location for the next

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70. KRUGMAN ET AL., *supra* note 66, at 150.

71. Alex Ben Block, *Report Warns That California Isn't Doing Enough to Retain Movie*, *TV Productions*, HOLLYWOOD REP. (June 14, 2012, 5:57 PM), http://www.hollywoodreporter.com/news/California-runaway-production-tax-incentive-337952. Louisiana was the second most successful, behind only New York, in drawing away productions from California during 2009 and 2010. *Id.*

72. *Id.*

73. Jeff Adelson, *Film Tax Credits Cost State Too Much, Report Says*, NOLA.COM (Aug. 7, 2012, 9:45 PM), http://www.nola.com/politics/index.ssf/2012/08/film_tax_credits_cost_state_to.html.

74. Zolt, *supra* note 25, at 63.

75. *See* KRUGMAN ET AL., *supra* note 66, at 150.

76. *Id.*

77. ECON. RESEARCH ASSOCS., LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES (2009), *available at* http://www.louisianaeconomicdevelopment.com/documents/additional-resources/ERA_Entertainment_Report.pdf. The Stanley Kubrick film *Eyes Wide Shut* was proclaimed "one of the longest shoots ever bankrolled by a major studio" after it took around three years to finish shooting. Benjamin Svetkey, "*Behind the Scenes of "Eyes Wide Shut*", ENT. WKLY. (July 23, 1999), http://www.ew.com/ew/article/0,,20471622_272431,00.html.

production.[78] This also suggests a relatively elastic supply of film production. Since relevant indicators suggest that the supply of film production is likely elastic, assuming it is a reasonable goal to draw more film production to Louisiana, the MPITC *may be* efficient because it can effectuate its goal of drawing in new producers.[79]

B. Efficiencies and Externalities

Elasticity is just one method of evaluating tax policy efficiency. In a perfectly competitive market, market demand and market supply will intersect at the competitive equilibrium that is also the most efficient point, and if it is not at that point, the market will adjust to reach it.[80] Therefore, if the film production market was in a perfectly competitive equilibrium before the intervention of the MPITC, the MPITC would be harmful because it would misallocate resources.[81] However, externalities often inhibit perfectly competitive markets. An externality occurs when the action of one party makes another party worse or better off, yet the first party neither bears the cost nor receives the benefits of doing so.[82] Externalities can arise either from the production of goods or from their consumption.[83] Externalities can be positive or negative.[84] Possible positive externalities caused by the film industry's presence in Louisiana are the creation of thousands of new jobs and, in turn, new taxpayers.[85] A negative externality might be high levels of pollution that make film production in Louisiana more costly.[86]

Both positive and negative externalities play an important role in determining if the MPITC is efficient. Economists have generally

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78. The producer is not locked into one location for long periods of time. Because of the quick film shoots, the producer can switch locations before the next production with ease.

79. Both the availability of inputs and time factor suggest a relatively elastic supply.

80. BRADLEY R. SCHILLER, ESSENTIALS OF ECONOMICS 119–22, 135 (8th ed. 2011).

81. Interfering with a perfectly competitive market pushes the market to an equilibrium that is inefficient. This inefficiency creates social loss, or what is known in economic terms as "dead weight loss." This loss occurs by prohibiting wealth generating transactions that would have occurred but for the government intervention. JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 125 (Sarah Dorger et al. eds., 3rd ed. 2011).

82. *Id.* at 122.

83. For the purposes of this Comment, only externalities resulting from the production of goods are relevant because the MPITC is a subsidy offered only to film producers.

84. *Id.* at 123.

85. Lopez, *supra* note 10.

86. *See infra* note 99.

accepted that where an externality is present, tax policy can be used as a tool for correcting inefficiencies in the competitive allocation of resources.[87] However, to be efficient, the level of government interference should mirror the size of the externality it seeks to confront.[88] Therefore, to determine if the MPITC is efficient based on its ability to properly confront externalities, it must be determined whether an externality exists and whether the externality is of similar size to the MPITC.

1. Positive Production Externalities

Positive production externalities occur when a firm's production increases the well-being of others without compensation from the benefitted party.[89] Generally, it is best to encourage this positive externality-generating activity to increase the benefits produced to other members of society.[90] To do this, the government subsidizes the behavior that generated the positive externalities so that the market price reflects the social value of the good.[91] The social value of the good is the private value to consumers plus the value of the positive externalities the good generates.[92] Tax credits can achieve this social value of production by making a good less expensive to produce so that producers will be incentivized to produce more of this positive externality-creating commodity.[93]

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87. Agnar Sandmo, *Optimal Taxation in the Presence of Externalities*, 77 SWEDISH J. OF ECON. 86, 86 (1975), *available at* http://www.jstor.org/stable/3439329.

88. *Id.*

89. GRUBER, *supra* note 81, at 128.

> Imagine the following scenario: There is public land beneath which there *might* be valuable oil reserves. The government allows any oil developer to drill in those public lands, as long as the government gets some royalties on any oil reserves found. Each dollar the oil developer spends on exploration increases the chances of finding oil reserves. Once found, however, the oil reserves can be tapped by other companies; the initial driller only has the advantage of getting there first. Thus, exploration for oil by one company exerts a *positive production externality* on other companies: each dollar spent on exploration by the first company raises the chance that other companies will have a chance to make money from new oil found on this land.

Id.

90. *Id.* at 129.

91. Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 44 (2006).

92. *Id.*

93. Clinton G. Wallace, *The Case for Tradable Tax Credits*, 8 N.Y.U.J.L. & BUS. 227, 228–30 (2011).

Motion picture production in Louisiana is subsidized through the MPITC because the credits make production less expensive for producers.[94] This would only be efficient if in-state film production generated positive externalities, and the level of the subsidization would only be efficient if it equaled the value of the positive externalities being generated.[95] Possible positive externalities caused by film production include manual labor work, catering, transportation, and financial services, which also create thousands of new jobs and, in turn, new taxpayers within Louisiana.[96] Production staff frequent local businesses, which also causes many positive externalities. If these staffers are from out of state, the money they spend in local businesses would not have otherwise been infused into Louisiana's economy. Additionally, the new group of producers may entice other new businesses to relocate to Louisiana.

Although some positive externalities may be generated, for the MPITC to be efficient it is also essential that the level of the subsidy balance the externalities. The value of positive externalities is difficult to derive because it is impossible to differentiate between positive economic effects that are a result of the newly created film industry and those effects attributable to other factors. For instance, if an out-of-state worker from a film goes to a coffee shop everyday and spends money at that business, this is a positive externality. The only way to attempt an exact calculation of the positive externality generated by this worker, however, would be to require film workers to identify themselves to businesses where they spend and for businesses to record and report these sales separately from their regular business. However, considering the amount of credits awarded under the MPITC—$231 million from just 2011 to 2012—the positive externalities would need to be huge for the MPITC to be efficient.[97]

Louisiana has yet to witness this scale of positive economic side effects.[98] From 2009 to 2012, real GDP grew in Louisiana by an average of 1.975%.[99] Compared to the amount being spent on the

94. *See* discussion *supra* Part I.
95. *See* discussion *infra* Part II.C.1.
96. Lopez, *supra* note 10.
97. Maginnis, *supra* note 22.
98. The average percent change in Real GDP from 2009 to 2012 was a modest 1.975% (3.2% in 2009; 5.8% in 2010; -2.6% in 2011; 1.5% in 2012). News Release, Bureau of Economic Analysis, U.S. Department of Commerce, Widespread Economic Growth in 2012, Table 1, *available at* http://www.bea.gov/newsreleases/regional/gdp_state/2013/pdf/gsp0613.pdf. Comparatively, Louisiana's Real GDP growth ranked 30th in 2012. *Id*.
99. *Id.* It is important to note this figure encompasses the Great Recession; however, comparing Real GDP growth to other states yields the conclusion that Real GDP growth in Louisiana during this time was conclusively weak.

MPITC by Louisiana, this GDP growth is unimpressive and indicates that whatever positive production externalities created are not large enough to justify the MPITC's massive size.

2. Negative Production Externalities

Negative production externalities occur when a firm's production reduces the well-being of others who are not compensated by the firm.[100] Generally, the government provides subsidies to industries that would otherwise under-produce due to various market and governmental failures or externalities.[101] Subsidization through a tax credit is arguably more efficient than subsidization via direct governmental grants because the cost of determining which projects to subsidize is allocated to individuals receiving the credit.[102] This means those recipients will choose to subsidize their most valued project, and the government will not have to waste resources figuring out which projects to subsidize.[103] However, this subsidization is only efficient where there is a negative production externality present and the subsidization is commensurate to the externality.

Louisiana had a film industry before tax credits, which in itself is evidence there was never a large-scale negative externality facing Louisiana.[104] The success of the old Louisiana film industry was borne mostly by New Orleans as a popular setting for storylines and on-location filming.[105] Yet, even outside of the traditional New Orleans film industry in Louisiana, the State has a varied landscape that is attractive to film production. As one commentator noted,

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100. GRUBER, *supra* note 81, at 124. The classic example of a negative externality is pollution. For instance, say a steel plant is located next to a river and dumps the sludge produced as a by-product into the river. This sludge then floats downstream into a traditional fishing area. The sludge kills the fish and imposes a cost on the fisherman who finds it increasingly more time consuming to find live fish.

101. Miranda Perry Fleischer, *Equality of Opportunity and the Charitable Tax Subsidies*, 91 B.U.L. REV. 601, 611 (2011).

102. *Id.* at 612.

103. *Id.*

104. Vicki Mayer & Tanya Goldman, *Hollywood Handouts: Tax Credits in the Age of Economic Crisis*, JUMP CUT, http://www.ejumpcut.org/archive/jc52.2010/mayerTax/ (last visited Nov. 4, 2013). Early films like *Mephisto and the Maiden*, 1909, *Tarzan of the Apes*, 1918, and *My Old Kentucky Home*, 1922, attracted directors, actors, and other early film professionals to the State.

105. *Filmography: 1898–1980*, LA. FILM MUSEUM, http://louisianafilmmuseum.org/Louisiana_Filmography.html (listing early Louisiana films such as *The Flame of New Orleans*, 1941, *Panic in the Street*, 1950, *A Street Car Named Desire*, 1951, *King Creole*, 1958, *Toys in the Attic*, 1963, *The Cincinnati Kid*, 1965, *Easy Rider*, 1969).

"Louisiana isn't just the boisterous Big Easy, soggy bayous and graceful old plantations draped with Spanish moss. The northeast has pine, forests, rolling hills and small towns that can double for many other places."[106] Louisiana also boasts a lower cost of living than the national average and much lower cost of living than the two largest film-producing states, California and New York.[107] Additionally, Louisiana ranks far below New York and California on the Milken Institute's Cost-of-Doing Business Index.[108] Because Louisiana can be easily transformed to fit almost any setting and the cost of living in Louisiana is much lower than California and New York, it is likely that Louisiana would be an attractive location for film productions *even without* the MPITC. Given the lack of any evidence of a large-scale negative externality present in the Louisiana film industry, far less costly means like advertising or a less expansive tax credit program could have enticed production in Louisiana.

This is not to say that Louisiana would be as attractive for film production without the MPITC as it is with the tax program. Rather, there is simply no evidence of a large-scale negative externality present in the pre-MPITC film industry in Louisiana such that substantial government intervention was necessary. However, this lack of evidence also does not preclude the existence of small externalities that would not be evident from the pre-2002 Louisiana film industry. Such negative externalities might be high crime rates, prevalence of natural disasters, or other factors that are keeping film producers who would otherwise choose to film in Louisiana from doing so.[109] Although not disposing of the possibility of small externalities, this evidence shows that large-scale negative

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106. Iain Blair, *Pros Pick Best Places for Filmmaking*, VARIETY (Oct. 23, 2009), http://www.variety.com/article/VR1118010354?refCatId=3782.

107. *Cost of Living*, CITYRATING.COM, www.cityrating.com/cost-of-living (last visited Sept. 20, 2013). The consumer price index (CPI) in Louisiana is 5.36%, lower than the national average. New York's CPI is 15.18% higher than the national average, and California's is 6.25% higher than national average.

108. THE MILKEN INSTITUTE, MILKEN INSTITUTE: 2007 COST-OF-DOING-BUSINESS INDEX (2007), *available at* www.milkeninstitute.org/pdf/2007Costof DoingBusiness.pdf. New York ranked 2nd, while California is ranked 4th and Louisiana is ranked 26nd on the index. *Id.*

109. Louisiana has been ranked for the past 20 years as the most violent state in the United States according to a report from the Institute of Economics and Peace. Meg Handley, *Louisiana Most Violent State in U.S.*, U.S. NEWS AND WORLD REP. (May 7, 2012), http://www.usnews.com/news/articles/2012/05/07/louisiana-most-violent-state-in-the-us. Louisiana has been ranked as the most disaster-prone state in the nation, largely because of Hurricane Katrina, which was the costliest disaster in U.S. history. Cameron Huddleston, *Top 10 States Most at Risk of Disaster*, KIPLINGER (June 19, 2012), http://finance.yahoo.com/news/top-10-states-most-at-risk-of-disaster.html.

production externalities were not present in the Louisiana film industry before the MPITC was instituted. The size of a subsidy confronting a negative externality should mirror the size of that negative externality.[110] The current size of the MPITC—$231 million from 2011 to 2012—would only be appropriate from an efficiency perspective if large-scale negative externalities existed.[111] Yet, because there is no evidence of such a negative externality present, this level of government intervention is overaggressive and inefficient.

C. Kaldor–Hicks Efficiency as a Cost–Benefit Analysis

Kaldor–Hicks efficiency is yet another metric used to measure the efficiency of tax policies.[112] Under this model, a state of affairs is only Kaldor–Hicks efficient if the "winners," or those better off in the move to a new state of affairs, can fully compensate the "losers," those whose welfare diminished.[113] Before 2002, the film industry in Louisiana was unsubsidized.[114] To estimate if the new state of affairs is efficient, one must consider the two parties: Louisiana taxpayers and the producers of the films made in Louisiana. The producers represent those whose welfare is increased by the move to the new state of affairs in which film production in Louisiana is generously subsidized by the MPITC, while the taxpayers represent those whose welfare has been diminished because other beneficial uses for tax dollars must be forgone to fund the MPITC. Therefore, if the post-MPITC state of affairs is to be Kaldor–Hicks efficient, the producers must be compensating the Louisiana taxpayers.

Performing a cost–benefit analysis creates a clearer picture of if Kaldor–Hicks efficiency is being reached through the MPITC. According to a recent study, Louisiana certified $196.8 million in film tax credits in 2010 alone.[115] During that same year, the MPITC

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110. A tax used to correct an externality should "confront the externality with a price reflecting the damage (or benefit, as the case may be)." Sandmo, *supra* note 87, at 86.

111. MATHIS, *supra* note 3.

112. Crawford, *supra* note 24, at 516.

113. Shannon Weeks McCormack, *Taking the Good with the Bad: Recognizing the Negative Externalities Created by Charities and Their Implications for the Charitable Deduction*, 52 ARIZ. L. REV. 977, 999 (2010) (citing JULES L. COLEMAN, MARKETS, MORALS, AND THE LAW 98 (1988)).

114. LA. REV. STAT. ANN. § 47:6007 (2009).

115. Millhollon, *supra* note 13. These economic contributions include payroll, purchases, and other economic activity in Louisiana. *Id.* This equates to roughly $1.00 of state tax income for every $7.29 in credits.

generated an estimated $27 million in state tax revenue.[116] That was a dismal return on investment at about -86.28%.[117] However, welfare economics's notion of individual well-being is concerned with more than just simple returns on investment, and it incorporates any other return in value, however intangible.[118] Therefore, to address whether the producers are compensating the Louisiana taxpayers, more than just simple returns on investment must be analyzed.

1. Benefits of the MPITC

Positive impacts of the film industry are often broken down into "direct" impacts and "indirect" impacts.[119] Direct impacts include: employment of a local workforce and external production such as rooms at area hotels or increased restaurant and retail revenue.[120] Indirect impacts are the non-quantifiable effects that film production has on the local economy such as feelings of excitement and pride that Louisianans experience.[121]

In regard to direct impacts, the film industry brings numerous jobs to the State, many of which are higher paying than other jobs in Louisiana.[122] According to a 2009 Project Report, "[p]revious efforts at workforce and infrastructure development are beginning to pay dividends, and new businesses have been founded and are moving to the state from elsewhere."[123] The average hourly wage for those employed in the motion picture industry is generally much higher than those employed in all other industries.[124] For instance, writers and authors working on a motion picture earn 56% more on

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116. *Id. See also* Joseph Henchman, *Important Questions to Ask in Evaluating a Film Tax Incentive Program*, TAX FOUND (Mar. 22, 2012), http://taxfoundation.org/article/important-questions-ask-evaluating-film-tax-incentive-program. Another independent study found the return, accounting even for movie-induced tourism, increased business to non-film businesses and other indirect effects is on average between $0.13 and $0.15 on the dollar. This study supports an R.O.I. approximately between -85% and -87%.

117. Return on Investment = (Gain from Investment – Cost of Investment)/Cost of Investment.

118. Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 967 (2001).

119. LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES, *supra* note 77.

120. *Id.*

121. *Id.* at 24.

122. Grand, *supra* note 11. Employment in film production tends to pay higher wages than comparable employment using the same skills. *Id.*

123. LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES, *supra* note 77, at 1.

124. *Id.*

average than writers and authors who work in other media.[125] On average a worker in the media industry earns 20.33% more per hour than the national average for all workers.[126] This is a welcome trend in Louisiana, as the per capita personal income in the State ranks 31st in the United States.[127]

Because of the contingent and transient character of employment in the motion picture industry, employment is difficult to measure.[128] However, studies show that film industry employment has increased at a compound annual growth rate of 22% from 2001 to 2007.[129] Louisiana also boasts the film industry's fifth highest "location quotient," or proportion of workers in a particular industry in a state compared to the national employment in that industry.[130] In 2007 alone, expenditures of film producers taking advantage of the credit created 6,230 jobs.[131] This increase in jobs coupled with the higher paying nature of film industry employment is certainly a great benefit to Louisianans.

In addition to the jobs directly related to production, local sectors—such as transportation, lodging, car and truck rentals, gas stations, food and beverage establishments, retail, construction and repair, equipment rentals, personal, business, and government services—all benefit from production.[132] Out-of-state producers and their employees spend money in multiple sectors that would otherwise not benefit Louisiana residents and businesses.[133] Such a boon to the local economy is a further direct benefit to Louisianans as a result of the MPITC.

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125. *Id.* at 23.

126. In Louisiana, the mean hourly wage for all occupations in 2012 was $18.86, compared to those in arts, design, entertainment, sports, and media occupations who earned a mean hourly wage of $21.33. U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, MAY 2012 STATE OCCUPATIONAL EMPLOYMENT AND WAGE ESTIMATES LOUISIANA (2013), *available at* http://www.bls.gov/oes/current/naics4_512100.htm#00-0000.

127. U.S. DEPARTMENT OF COMMERCE: UNITED STATES CENSUS BUREAU, PERSONAL INCOME PER CAPITA IN CURRENT DOLLARS (2007), *available at* http://www.census.gov/statab/ranks/rank29.html.

128. LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES, *supra* note 77, at 6.

129. *Id.* at 28.

130. *Id.* at 31 (as of 2007).

131. *Id.* at 32.

132. *Id.* at 23. A greens man or costume designer working on a film production can earn nearly double their regular earnings from what they would otherwise make in a non-production-related job.

133. Grand, *supra* note 11.

Indirect benefits such as the increased excitement and pride of local residents have garnered widespread attention in Louisiana.[134] As previously stated, Louisiana is ranked third in the country in film production activity, behind only California and New York.[135] Productions spurred by the credit have helped earn Louisiana the nickname "Hollywood South,"[136] a moniker in which many Louisiana residents take pride.[137] The MPITC has created many direct and indirect benefits to the State's economy and people.

2. Costs of the MPITC

With benefits readily flowing into Louisiana, the MPITC has gained great support throughout the State.[138] However, many remain skeptical, and state representatives have voiced concerns over the program's effective job creation and ability to spur a self-sustaining film industry, urging that the program needs to be reevaluated.[139]

Although many proponents tout job creation in the State, a large portion of the jobs that film productions create, especially those with the highest pay, are actually filled by nonresidents.[140] Furthermore, the jobs that are created by the MPITC are very expensive for the State. By one estimate, each job created by the MPITC costs the State $60,000.[141] On average, Louisiana spent 9% more to create each job than the average salary earned by a Louisiana film worker.[142] This 9% is spent just on those positions that are actually filled with Louisianans, which is not always the case.

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134. Even Sen. Mary Landrieu has recently expressed excitement over "Hollywood South," tweeting "Louisiana's film industry is giving #Hollywood a run for its money. Congrats to Hollywood South on its 2 #Oscarnoms." (referring to *Beasts of the Southern Wild* and *Django Unchained*'s combined seven Academy Award nominations in 2013). Alicia M. Cohn, *Sen. Landrieu 'Proud' of Louisiana-Filmed Oscar Nominees*, THE HILL (Jan. 10, 2013, 12:17 PM), http://thehill.com/blogs/twitter-room/other-news/276491-sen-landrieu-proud-of-louisiana-filmed-oscar-nominees.

135. Lopez, *supra* note 10.

136. Bailey, *supra* note 12, at 715.

137. Elizabeth Vowell, *Hollywood South Wraps 2012, Looks Forward to 2013*, WAFB NEWS (Dec. 31, 2012), http://wsmv.membercenter.worldnow.com/story/20475797/hollywood-south-wraps-2012-looks-forward-to-2013.

138. *Id.*

139. Millhollon, *supra* note 13. State Rep. "Jim Fannin, D-Jonesboro, who sponsored the State's budget bill, said the film production tax credit program needs to be reviewed because it does not appear to be cost effective." *Id.*

140. *Id.*

141. Adelson, *supra* note 73. "The state's film tax credits cost the state about $60,000 for each direct job they create." *Id.*

142. MAY 2012 STATE OCCUPATIONAL EMPLOYMENT AND WAGE ESTIMATES LOUISIANA, *supra* note 126. According to the Bureau of Labor Statistics, workers

Film production is a highly mobile industry.[143] In general, most crewmembers are hired locally, while top personnel, like directors and producers, travel extensively from job to job.[144] These nonresident top personnel enjoy the best jobs with the highest incomes.[145] Even the local crewmember jobs are characterized by seasonal, short-term projects in Louisiana, not full-time, year-round employment as in other parts of the country.[146]

Additionally, there is extreme competition between states and other countries, making it difficult for one location to become the clear winner of the "film subsidy war."[147] Louisiana and New Mexico currently enjoy a "first-mover advantage" because they were the first states to enact film incentives.[148] However, a first-mover can only capture most of a market where an industry is characterized by a tendency of firms to cluster together and requires a large initial investment.[149] Because film production is such a mobile industry, agglomeration is unnecessary.[150] Recall, film production has a relatively elastic supply making it receptive to price changes.[151] Therefore, the first-mover advantage may be short-lived and is possibly unsustainable in light of increased competition.

While the MPITC has generated excitement, job creation, and a prevalent industry, the cost of this creation is enormous to Louisiana taxpayers.[152] Not only is the basic return on investment -86.28%, but the jobs created also cost Louisiana far more than those jobs actually pay Louisiana workers.[153] In 2002, the Louisiana Legislature set out

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across the nation in art, design, entertainment, sports, and media occupations earn an average of $54,490. *Id*. Compared to the $60,000 average spent to create each job, the cost to create a job is approximately 9% higher than the average salary earned.

143. Adelson, *supra* note 73.

144. ROBERT TANNENWALD, CTR. ON BUDGET & POL'Y PRIORITIES, STATE FILM SUBSIDIES: NOT MUCH BANG FOR TOO MANY BUCKS (2010), http://www.cbpp.org/files/11-17-10sfp.pdf (citations omitted).

145. *Id.*

146. LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES, *supra* note 77.

147. TANNENWALD, *supra* note 144.

148. *See* LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES, *supra* note 77.

149. ENRICO MORETTI & DANIEL J. WILSON, FED. RESERVE BANK OF SAN FRANCISCO, STATE INCENTIVES FOR INNOVATION, STAR SCIENTISTS AND JOBS: EVIDENCE FROM BIOTECH (July 2013), *available at* http://www.frbsf.org/economic-research/files/wp2013-17.pdf.

150. Adelson, *supra* note 73.

151. *See* discussion *supra* Part II.A.

152. *See* MATHIS, *supra* note 3.

153. *See supra* notes 118, 143.

to "encourage development in Louisiana of a strong capital and infrastructure base for motion picture production in order to achieve an independent, self-supporting industry."[154] Yet, the past ten years have indicated the industry is hardly self-supporting.[155] Since 2002, Louisiana taxpayers' welfare has been diminished by diverting state funds to support the film industry without adequate compensation from film producers who benefit greatly from the MPITC. Because there has not been adequate compensation from those whose welfare has increased to those whose welfare has diminished, the MPITC is overaggressive and not Kaldor–Hicks efficient.

D. Consolidating Efficiency Analyses

These three conceptions of efficiency help draw the conclusion that the MPITC is overaggressive, but this does not mean the MPITC is without merit. Film production is the type of industry that responds well to subsidization because of its relatively elastic supply. Additionally, film production produces some positive externalities, and the possible presence of small negative externalities may warrant some government intervention in the film production market. Also, Louisianans benefit from the new, subsidized state of affairs in several capacities. Nevertheless, the sheer size of the MPITC renders it inefficient. The analysis of the three theories of efficiency indicate that while subsidizing the film industry may be a good general strategy, the program's over-aggressiveness renders it inefficient. As this Comment later argues, Louisiana may be able to retain the benefits of the MPITC by reducing the scope of the tax program.[156]

III. "LIFE IS A BANQUET, AND MOST POOR SUCKERS ARE STARVING TO DEATH":[157] EQUITY CONCERNS OF THE MPITC

In addition to devising an efficient tax scheme, tax policymakers must consider the fairness of a tax design.[158] However, fairness of a tax system greatly depends on perspective,[159] and though everyone may agree that taxation should treat taxpayers equitably, they may not agree on what constitutes "equitable treatment."[160]

154. LA. REV. STAT. ANN. § 47:6007 (2009).
155. *See generally* BAXTER, *supra* note 8.
156. *See* discussion *infra* Part IV.
157. AUNTIE MAME (Warner Bros. Productions 1958).
158. LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP TAXES AND JUSTICE 149 (2002).
159. Zolt, *supra* note 25, at 43.
160. MURPHY & NAGEL, *supra* note 158, at 162.

Tax equity is usually bifurcated into two concepts: vertical equity and horizontal equity.[161] "Vertical equity" means the degree of fairness in the treatment of people at different income levels, while "horizontal equity" means the fairness in treatment of people at similar income levels.[162] However, tax scholars generally believe that vertical equity is more analytically fundamental.[163] This is because horizontal equity is only significant if people believe persons with the same levels of income should be taxed differently, which is largely untrue.[164] Therefore, this Comment is only concerned with vertical equity, or the fairness of the MPITC's treatment of people at different income levels. An analysis of the MPITC's treatment of people at different income levels indicates that the MPITC unfairly benefits the wealthy and harms the average Louisiana taxpayer due to its massive size.

The MPITC only allows the wealthy to displace their tax burdens; only wealthy film producers with large budgets can take advantage of the program,[165] and the credits are only awarded to those productions that are able to demonstrate a viable multimarket commercial distribution plan and incur at least $300,000 of production expenditures.[166] These requirements are easily met by productions backed by the six largest movie production companies,[167] which command approximately 90% of the U.S. and Canadian box office.[168] The cost of producing and marketing these large feature films averages about $100 million per film.[169] Independent filmmakers outside of the major six production studios, however, simply do not have the means to qualify for the credit.[170]

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161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*
165. LA. REV. STAT. ANN. § 47:6007 (2009).
166. Calhoun, *supra* note 27, at 90.
167. *See generally* BAXTER, *supra* note 8, at 11 ("The motion picture industry has historically been dominated by several large studios based primarily in Hollywood. These include Sony Pictures, 20th Century Fox, The Walt Disney Co., Warner Bros, Paramount Pictures, and NBC Universal.").
168. Bryan Ross Bieber, *Analysis of the Independent Film Industry*, BRB PRODUCTIONS (Sept. 23, 2009), http://www.bryanbieber.com/2009/09/analysis-of-the-independent-film-industry.
169. BAXTER, *supra* note 8, at 11.
170. "Independent films" are those films produced outside of the major six Hollywood production companies. Digital film has helped increase film production dramatically. Bieber, *supra* note 168. In 2008 alone, 5,000 films were submitted to the Sundance Film Festival. *Id.* Because of the increased supply, it is no longer possible to approach a major studio and have them commit to distribution. *Id.* Given the high-capital investment necessities imposed to meet the requirements to receive the credits, including a viable multimarket commercial

Moreover, it is not just among film producers that the MPITC causes such great disparity in vertical equity. The private resale market also functions to only allow the wealthy to offset their tax liability. Because of the complicated nature of monetizing and transferring the credits, it is extremely risky to engage in their resale without professional assistance.[171] Since the accounting firms that typically facilitate credit transfers only do so when a client has a significant state income tax liability,[172] it would likely be very difficult for taxpayers willing to take the risk of purchasing credits without professional assistance to even access the credits for sale.[173]

However, the non-wealthy might benefit from other aspects of the MPITC. Job creation and possible positive externalities benefit both the wealthy and non-wealthy.[174] Yet, because the wealthy can offset their tax liability while the non-wealthy cannot, there is significant vertical inequity. This is an important concern given the magnitude of the program, particularly in light of Louisiana's current budget crisis.[175] As Jan Moller, the director of the Louisiana Budget Project, stated, "It's a question of priorities and [the Louisiana Budget Project] think[s] it's probably time to start reigning in the cost of these subsidies . . . . The question is not

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distribution plan, independent film producers cannot reap the benefits of the program. LA. REV. STAT. ANN. § 47:6007(C)(1)(c)(i) (2009) (amended 2013). Only the wealthy major Hollywood studios can easily take advantage of the MPITC, while modest, small, independent producers will likely find the credits unobtainable.

171. *See* discussion *supra* Part I.

172. Because of the amount of hours of work a completed transfer takes even tax professionals, most accounting firms would not consider the transfer unless their client had a significant income tax liability. While difficult to determine an exact threshold, most accounting firms would begin to consider using credits if state income tax liability was significant.

173. The key is that the larger the volume per transfer, the less credit sellers have to pay in transfer fees and the less work they need to put into transfers. Sellers of credits have little incentive to sell in small quantities and pay a fee of $200 per transfer when large brokers of accounting firms can buy all their credits with just one transfer fee. Revenue Information Bulletin No. 10-022 State of Louisiana Department of Revenue (2010). A $200 fee per transferee is imposed.

174. *See* discussion *supra* Part II.C.1.

175. Paul Rioux, *Gov. Bobby Jindal Says Budget Crisis Calls for Spending Cuts, Not Tax Increases*, THE TIMES-PICAYUNE (Apr. 19, 2011, 4:17 PM), http://www.nola.com/politics/index.ssf/2011/04/gov_bobby_jindal_says_budget_c .html. Gov. Bobby Jindal referred to a $1.6 billion budget shortfall as the State's next major crisis. *Id.*

whether we want the film industry here, the real question is what are we willing to pay to bring them here?"[176]

Louisiana is making huge cuts to state expenditures that benefit the wealthy and non-wealthy alike, such as healthcare and education, while significantly increasing spending on film subsidies that benefit the wealthy over the non-wealthy.[177] From a vertical equity standpoint, the current trend of the MPITC is undesirable because it only benefits the wealthy and not the typical Louisiana taxpayer.[178]

However, this is not to suggest that subsidizing film productions is per se inequitable. Rather, the *level* of subsidization is inequitable given the current state of the Louisiana budget. If the size of the MPITC is scaled back and the disparity between the wealthy and non-wealthy lessened, then the MPITC could achieve more vertical equity. Additionally, if less state funds went to subsidizing films, more funds could be allocated to government and private sector programs that benefit both wealthy and non-wealthy residents.

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176. Brittany Weiss, *La. Film Tax Credits Becoming Costly*, WBRZ.COM (Oct. 18, 2012, 4:46 PM), http://www.wbrz.com/news/la-film-tax-credits-becoming-costly/. Note that the Louisiana Budget Project is a part of the Centers on Budget and Policy Priorities that describes itself as a "policy organization working at the federal and state levels on fiscal policy and public programs that affect low- and moderate-income families and individuals" and is known to be somewhat liberal leaning. *See About*, OFF THE CHARTS BLOG, http://www.offthechartsblog.org/about/ (last visited Nov. 5, 2013); *see also* Harold Pollack, *Where's the Conservative Counterpart to the Center on Budget and Policy Priorities?*, INCIDENTAL ECONOMIST (Apr. 14, 2012, 11:47 AM), http://theincidentaleconomist.com/wordpress/wheres-the-conservative-counterpart-to-the-center-on-budget-and-policy-priorities (noting the Center on Budget and Policy Priorities is "avowedly liberal").

177.

> Lawmakers recognize that many of the existing 422 tax breaks do a lot of good, but they aren't sure which ones are not, or whether a fraction of the $6.8 billion total would not be better spent on health care and higher education . . . . Louisiana's generous motion picture tax credit, at $174 million in [Fiscal Year] 11 and growing, has brought many productions and great industry exposure to the state, but, with some exceptions, has not resulted in the permanent jobs and capital investment earlier envisioned. But we are assured the pipeline of projects would quickly run dry without the state subsidy.

Maginnis, *supra* note 22.

178. Increasing spending on things that heavily benefit the wealthy over the non-wealthy, while making large cuts to that which benefits both the wealthy and the non-wealthy alike, is contradictory to the principles of vertical equity. MURPHY & NAGEL, *supra* note 158, at 162 (noting vertical equity is what fairness demands in the tax treatment of people at different levels of income).

IV. THE SHOW MUST GO ON: REFORMULATING THE LOUISIANA MOTION PICTURE INVESTOR TAX CREDIT

This Comment has shown that while the MPITC is generally an effective means to incentivize film production, the overaggressive nature of the MPITC renders it inefficient and inequitable. In order to better effectuate a self-sustaining film industry, the MPITC must be re-envisioned to "limit the cost to taxpayers without pulling the rug out from under the industry."[179] By implementing two changes to the programs, the MPITC will become more efficient and will produce more vertical equity. First, this Comment advocates for a statutory annual cap on the MPITC and an accompanying auction-like system for awarding available credits. Second, this Comment suggests an explicitly limited definition of production expenditures to mitigate risk associated with credits and decrease the amount of expenditures that qualify for the MPITC.

A. Imposing a Statuary Annual Cap on the Amount of Credits Awarded

In order to provide for a more efficient tax scheme, the Legislature should impose a statutory annual cap on the amount of credits the LED may award. By offering a tax credit of 30% of production expenditures, Louisiana already provides one of the most attractive film subsidies in the nation.[180] This rate is much higher than those in other states, and other states are further reducing their rates.[181] Because of this comparatively higher rate, the MPITC will continue to incentivize out-of-state producers to film in Louisiana, while the imposition of a cap would limit the cost to taxpayers.

The statutory annual cap on the MPITC should be placed at a level low enough that producers must be competitive to obtain the credits but not so low as to discourage producers from applying for fear of rejection. The preference of Louisiana taxpayers to invest in film production in the State, especially amid cuts to healthcare and higher education, should also be included to address equity concerns.[182] New Mexico recently capped its program at $50 million

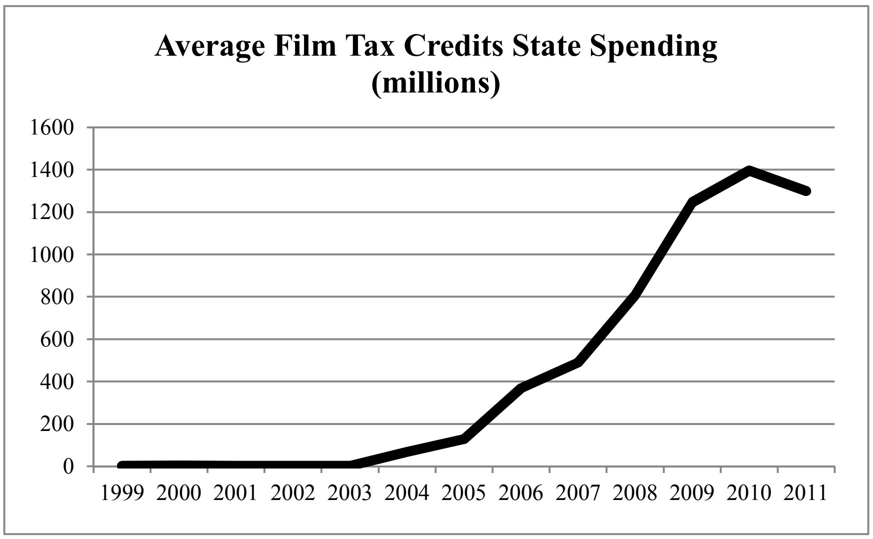
179. David Jacobs, *La. Budget Project Recommends Scaling Back Film Incentives*, BATON ROUGE BUS. REP. (Aug. 7, 2012, 3:15 PM), http://www.225batonrouge.com/article/20120807/BUSINESSREPORT0112/120809841.

180. LA. REV. STAT. ANN. § 47:6007 (2009).

181. Joseph Henchman, *More States Abandon Film Tax Incentives as Programs' Ineffectiveness Becomes More Apparent*, TAX FOUND. (June 2, 2012), http://taxfoundation.org/article/more-states-abandon-film-tax-incentives-programs-ineffectiveness-becomes-more-apparent.

182. Maginnis, *supra* note 22.

per year and employed a rolling cap process that allows productions to carry leftover tax credits over into the ensuing fiscal year once the cap is reached.[183] New Mexico certified $65.9 million in tax credits in 2010, and the subsidy rate was 25%.[184] Therefore, the $50 million cap was about 23% lower than the previous year's open-ended level.[185] This follows the national trend of states' attitudes toward film tax incentive programs, as 16 states have dropped, suspended, or drastically scaled back their programs.[186] The following graph illustrates the national spending trends with regard to film tax credits.[187]



Louisiana should follow these national trends. There is little risk that film producers will begin to prefer other states' subsidies because other states' rates are not nearly as high as the MPITC's, and Louisiana can save a significant amount by capping the credits. Additionally, since New Mexico has capped its level 23% lower than Louisiana's open-ended level,[188] Louisiana can reduce its

183. MATHIS, *supra* note 3.
184. Richard Verrier, *New Mexico Senate OKs $50-million Cap on Film Tax Rebates*, L.A. TIMES (Mar. 17, 2011), http://articles.latimes.com/2011/mar/17/business/la-fi-0317-ct-new-mexico-20110317.
185. ($50 million cap – $64.9 million 2010 level)/ $64.9 million 2010 level.
186. Henchman, *supra* note 181. Arizona, Arkansas, Idaho, Iowa, Kansas, Maine, New Jersey, and Washington all either suspended or dropped their programs. Alaska, Connecticut, Georgia, Hawaii, Michigan, Missouri, New Mexico, Rhode Island, and Wisconsin all scaled back. *Id.*
187. *Id.*
188. *See supra* note 186.

subsidy level by at least that amount without worry that a cap will shift preferences toward New Mexico.

In 2011 to 2012, Louisiana paid $231 million in credits at a 30% rate.[189] However, this was a sharp spike from previous years.[190] On average, Louisiana has spent about $153.82 million on film tax credits per year in the past five years.[191] Because Louisiana has a much larger uncapped level of credits awarded, the cap should be set at a similar percent decrease as the New Mexico program so as not to "pull the rug out from under the industry."[192] Using New Mexico's 23% scale back as a benchmark, Louisiana should decrease its average uncapped level—$153.82 million—by 23%.[193] This would mean a statutory cap placed around $118.44 million.

B. Auctioning off the Credits

Decreasing the overall size of the MPITC will address the inefficiency created by the program's massive size. Additionally, the State should adopt an auction-like system to disperse the credits. Because the MPITC is so lucrative for film producers, offering one of the largest film tax credits in the nation, the cap will introduce scarcity into the market for Louisiana film tax credits that will in turn create beneficial competition among producers.[194]

The LED currently awards credits to producers after considering the criteria set out in the MPITC, which provides, in pertinent part, that when determining which productions should be awarded credits, the LED "shall take the following factors into consideration: (i) [t]he impact of the production on the immediate and long-term objectives of this Section [and] (ii) [t]he impact of the production on the employment of Louisiana residents."[195] The purpose of the MPITC is to "encourage development in Louisiana of a strong capital and infrastructure base for motion picture production in order

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189. MATHIS, *supra* note 3.

190. *Id.*

191. *Id.* (stating that the State spent the following: $231 million in 2012, $179.5 million in 2011, $165.6 million in 2010, $101 million in 2009, and $92 million in 2008).

192. Leslie Turk, *Scrutiny Heats Up on State's Film Incentives*, ACADIANA BUS. (Aug. 7, 2011, 11:30 AM), http://www.theind.com/business/11129-scrutiny-heats-up-on-states-film-incentives.

193. MATHIS, *supra* note 3.

194. The Legislature has recently shown a continued commitment to the lucrative nature of the tax credits by declining to enact a proposed amendment that would have scaled the MPITC back to a 15% credit. H.B. 161, 2013 Leg., Reg. Sess. (La. 2013).

195. LA. REV. STAT. ANN. § 47:6007 (2009).

to achieve an independent, self-supporting industry."[196] To best effectuate these goals, the LED should award those credits to the productions that meet the two-part test laid out in the legislation.

In the proposed auction-like system, producers will present their prospective films to the LED and compete for the lucrative credits. The LED will decide to which films to award the credits based on the extent to which the films will impact development of a strong capital and infrastructure base and the employment of Louisiana residents.[197] Producers looking to ensure that their film secures the lucrative credits will make sure their production is appealing to the LED, possibly based on plans to use or invest in Louisiana production studios or promises to hire more Louisiana workers on a long-term basis. This will sufficiently address one of the largest complaints about the MPITC: Production companies are not hiring Louisiana workers long-term.[198] If only those producers who demonstrate a plan that effectuates the statutory goals are awarded the lucrative credits, producers in the auction system will compete head-to-head to show that their production will best benefit the State. A yearly auction system for the credits will help the LED determine which productions should be awarded the credit and will help enhance competition between producers, which benefits the State by addressing the efficiency and equity concerns.

C. Narrowing the Definition of Production Expenditures

The final suggested change is to tighten up the notion of production expenditures. Currently, the legislation defines production expenditures as:

> [P]reproduction, production, and postproduction expenditures in this state directly relating to a state-certified production, including *without limitation* the following: set construction and operation; wardrobes, makeup, accessories, and related services; costs associated with photography and sound synchronization, lighting, and related services and materials; editing and related services; rental of facilities and equipment; leasing of vehicles; costs of food and lodging; digital or tape editing, film processing, transfer of film to tape or digital format, sound mixing, special and visual effects; and payroll.[199]

196. *Id.*
197. *Id.*
198. TANNENWALD, *supra* note 144.
199. LA. REV. STAT. ANN. § 47:6007 (2009) (emphasis added).

The open-ended language, particularly the inclusion of the phrase "without limitation," leads to several unwarranted costs of the program. These costs translate to inefficiency and inequity in the MPITC.

This Comment advocates for the removal of the phrase "without limitations" to cut costs of the MPITC by allowing fewer items to qualify as production expenditures, which would result in fewer credits awarded. This loose definition of production expenditures lends itself to shrewd investors taking advantage of the MPITC without actually contributing to the Louisiana film industry.[200] The investigation and eventual recapture of these questionable credits is costly to the LED and in turn to the State. Moreover, many of these questionable production expenditures likely go unnoticed, imposing unwarranted costs.

A more absolute definition of production expenditures, like an explicit listing in the absence of the "without limitation" phrase, will decrease the number of falsely awarded credits and hence slash the costs associated with their recapture. Leaving this language open-ended only encourages clever obstructions and increased costs for the LED.[201] Finally, if fewer items qualify as production expenditures, fewer credits will be awarded. Cutting these costs will decrease the overall size of the MPITC. This will address both the efficiency and equity concerns about the MPITC.

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200. A notable controversy surrounding what actually qualifies as a production expense under "set construction and operation" occurred in 2009. Jeff Adelson, *Movie Tax Credit Projects to be Checked for Abuse*, NOLA.COM (July 11, 2012, 10:30 PM), http://www.nola.com/politics/index.ssf/2012/07/movie_tax_credit_projects_to_b.html. Blaine Kern Artists and its partner, Louisiana Entertainment and Productions, claimed to have spent about $3.4 million producing a documentary called "Blaine Kern's Mardi Gras: Building of the Greatest Free Show on Earth." Kern and his associates were awarded about $1 million in credits. However, only about $173,000 was actually spent on expenses for making the film while the rest was spent on the production of the floats—Kern's usual expenses incurred for the work he did for carnival krewes. *Id.* The LED then conducted an audit and found the credits were wrongfully awarded because the building of the floats did not count as a production expenditure. *Id.* The LED commenced recapture of the already awarded credits and is now considering imposing criminal liability on Kern and his associates. *Id.* Stephen Moret, Economic Development Secretary, says now there are enough controls in place to prevent this type of misuse, but there is still no definitive answer about what exactly falls under the category of "production expenditures." *Id.*

201. The LED is a government entity. Although this change may not decrease the direct costs of the MPITC, it will reduce government costs indirectly. This still decreases the overall impact of the MPITC on Louisiana's budget.

CONCLUSION

Although on the right track, evaluation of the MPITC under an optimal tax theory analysis indicates that the current program is overaggressive, causing both inefficiency and inequity. The best way to make the program more efficient and more equitable is to decrease its overall size without eliminating the incentives for producers to relocate to Louisiana. Two ways to subtly decrease the size of the MPITC are to impose an annual statutory cap on the amount of credits awarded and narrow the scope of production expenditures that are eligible for credits. Altering the way the limited credits are allocated would also make the MPITC more beneficial to Louisiana. Using these three strategies, Louisiana can continue to enjoy benefits of becoming "Hollywood South" in a more efficient and equitable manner.[202]

Amelia Hurt[*]

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202. Recently, Gov. Bobby Jindal proposed eliminating the Louisiana state income tax. Mike Scott, *Film Industry Leaders Say Jindal Tax Plan Would Cripple Production; Administration Disagrees*, THE TIMES-PICAYUNE (Mar. 19, 2013, 7:45 PM), http://www.nola.com/movies/index.ssf/2013/03/louisiana_film_leaders_says_ji.html. Scrapping state income tax liability would render the MPITC credit as is essentially valueless because the credit functions to offset state income tax liability. *Id.* However, the plan was met with strong opposition, particularly from those looking to protect the Louisiana film industry. Mike Hasten, *Louisiana Senator Vows to Protect Movie Credits*, SHREVEPORT TIMES (Mar. 19, 2013), http://www.shreveporttimes.com/article/20130319/ENT21/130319026/Louisiana-senator-vows-protect-movie-credits. Although the plan subsequently failed, many forecast that there will be a resurgent push to eliminate the state income tax in the future. Luke Johnson, *Bobby Jindal Scraps Plan to Eliminate State Income Tax After Outcry*, HUFFINGTON POST (Apr. 8, 2013, 4:33 PM), http://www.huffingtonpost.com/2013/04/08/bobby-jindal-income-tax_n_3039317.html. If the state income tax is eliminated, the above analysis would surely be altered; however, the MPITC credit would be re-envisioned to offset another form of state tax liability.

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