Daily Journal

Bringing TV, film production back to California

Michael S. Sherman *is a partner with Reed Smith LLP. He can be reached at MSherman@ReedSmith.com.*

Michael Hartman *is an associate with Reed Smith LLP. He can be reached at MHartman@ReedSmith.com.*

Last month, Los Angeles Mayor Eric Garcetti fulfilled a campaign promise by appointing former president of the Academy of Motion Picture Arts and Sciences, Tom Sherak, as the official "film czar" of Los Angeles. As head of the city's Entertainment Industry and Production Office, Sherak will be tasked with trying to solve the problem of runaway production, which Garcetti has declared a civic emergency. He'll have his work cut out for him since the great bulk of production incentives in California are at the state, not local, level and there is significant inter-state and international competition. Presumably, Sherak will be spending a fair amount of time in Sacramento.

Runaway production refers to the exodus of film and television production from California to locations like the U.K., Canada, Louisiana, New Mexico, New York, Georgia and Puerto Rico that offer generous production incentives. Currently, 41 U.S. jurisdictions offer some form of tax credit or rebate incentive, and these incentives have successfully lured production away from California at an alarming rate. Most recently in Nevada, a 15 to 19 percent tax credit will be offered starting in January 2014. Even the federal incentive, the so-called "Section 181" (scheduled to expire Dec. 31, 2013) has done little to keep productions in the U.S. or California. According to a report by the California Film Commission, the percentage of television network hour-long series shot in California has declined from 89 percent in 2005 to only 37 percent in 2012. Production of major studio films has fared even worse for productions with budgets in excess of $75 million, like "Transformers 4" and "Pirates of the Caribbean 5," which do not qualify for the California incentive and have moved production to Michigan and Louisiana, respectively, to take advantage of incentive programs that may cover 35 percent of the production costs expended in those states.

In addition, the California post production, special effects and visual effects industry is facing similar competition from countries like Australia, Canada and New Zealand, and most recently New York state, which offer post production, special effects and visual effects-only incentives.

California enacted its own production tax incentive program in 2009, which the state Legislature has extended through 2017. However, the state's relatively modest $100 million cap on the annual available amount and 20 percent tax credit for films with budgets greater than $10 million but less $75 million, basic cable and syndicated television (network television generally doesn't qualify), or 25 percent for "independent films" and relocating television series, struggles to compete with other state incentive programs like New York's, which allocates $420 million of production tax incentives each year. In some competitive markets, the incentives can be greater than 30 percent of qualified expenses, and caps on annual allocations are either nonexistent or considerably higher than in California.

Further, because of limited funds California must hold an annual lottery in June of each year to assign the credits, making California's program even less competitive. This year, 31 film and television projects were selected from 380 applications (less than 10 percent). It is not surprising that some California lawmakers question the effectiveness of the program. Nevertheless, after five years, the data reveals that even California's hobbled program has had a broad reach and deep economic impact throughout the state.

For example, in 2012, while only 27 projects were allocated tax credits through the lottery, 73 projects eventually received the benefit of the tax credit program. One of those projects was Troika Pictures' and WWE Studios' "The Call," starring Halle Berry, which started on the waiting list at number 83. The production had already hired a local line producer and was set to begin pre-production in Ontario, where the tax incentive was 37 percent of qualified expenses, when the producers were notified that "The Call" was eligible for the California credit. They then moved the production, and over $10 million in spending, back to California.

The success of the tax incentive in luring "The Call" back to California illustrates an important point about the program. "California tax credits don't have to match out-of-state credits to be competitive," says Amy Lemisch, executive director of the California Film Commission, "because California offers many other advantages including skilled crews, studio facilities, production infrastructure and access to a great talent pool." However, while producers may prefer to shoot in California, because of the limited accessibility to and limited resources of the program, producers look elsewhere for some form of tax credit or incentive program to help cover production costs. "That's the current business model," Lemisch adds, "and there's no way around it." Thus far, $600 million in tax incentives have been awarded through the program which, according to the Film Commission, have generated more than $4.75 billion in direct spending in the state, including $1.5 billion in wages for below-the-line crew. This spending has a multiplier effect when the impact to the local economy, such as local hotels, food, transportation and other services, is taken into account. Moreover, the benefits of the program are not limited to the greater Los Angeles area; San Francisco, Alameda County, San Mateo County and San Diego County, among others, have all felt a significant positive economic impact from local production fostered by California's production incentives.

The program's return-on-investment presents a strong case for increasing the annual incentive. In addition, from a film finance and production planning perspective, there are other tweaks to the administration of the program that would make it a more effective tool in combating runaway production.

Once a preliminary tax credit certificate has been awarded, "the California tax incentive program is among the most efficiently administered in the country," says John Hadity, an executive vice president at Entertainment Partners. Hadity assists clients in applying for, managing and financing tax incentive allocations and says that the straightforward audit process and quick turnaround for credit reimbursements have made the program a draw for producers.

However, the program's lottery system, which allocates tax incentives for the entire fiscal year at once, results in a long waiting list, the uncertainty of which is problematic for producers. An unintended consequence of the lottery system is that it attracts projects that may not be fully prepared to go into production because they only get one shot at the brass ring. This, in part, accounts for why the credits trickle down to so many productions on the waiting list. In fact, at the end of fiscal year 2012-2013, $55 million that had been allocated in the lottery was not distributed either because the productions fell through, did not go into production within the six months mandated by the program, or ended up using less than the full amount of the allocated tax credit. California's guidelines require that a production begin principal photography within six months of receiving its tax credit certificate which, ostensibly, precludes productions that are planning on shooting between January and June.

Allocating the program's resources in two semi-annual disbursements might mitigate this inefficiency by focusing on productions that are actually prepared to go into production within six months. Further, a semi-annual disbursement would allow those planning to start production in January through June to apply to the program in December. Coupled with stricter application guidelines focused on readiness to produce, adding a second cycle of funding will likely decrease applications during any single disbursement, thereby decreasing the uncertainty of the lottery and waiting list.

In addition, to combat the erosion of television production, the tax incentive program offers a 25 percent tax credit to television series productions currently shooting out of state but desiring to return to California. However, relocating television series are also subject to the lottery. Last year, five cable and network television shows that wanted to relocate to California were not allocated credits in the lottery and subsequently never relocated.

Even this relocation incentive has a drawback, at least for other participants in the lottery. To incentivize runaway series to relocate, returning series productions that are selected in the lottery are guaranteed the 25 percent tax credit throughout the run of the series. Accordingly, the funds available through the lottery each year are depleted

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U.S. Court of Appeals for the 9th Circuit
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Entertainment & Sports
Bringing TV, film production back to California
LA may have a new "film czar," but bringing production back to California will require Sacramento to get busy revamping the state's modest tax incentive program. By **Michael S. Sherman and Michael Hartman**

Bankruptcy
Trend watch: WARN Act claims in bankruptcy cases
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by qualified continuing television series production. Given the high production cost of television series, the drain on the available tax credit funds is not insignificant.

Television series are one of the most stable sources of economic activity in the entertainment industry, and it should be a priority to bring already successful shows back to California. However, the statute that authorizes the production incentive program stipulates that the credits must be disbursed on a "first come first served basis." A couple of changes in the program would be beneficial: first, allow some priority to returning television series; and second, increase the annual amount available for the credit to take into account the amount devoted to recapturing runaway series production so that their guaranteed credits don't count against, or further deplete, the already modest $100 million cap amount. No lawmaker can dispute the success of a tax incentive that motivates the producers of a television series to relocate from another state to California regardless of where in California the production takes place.

Some competitive programs include a fully or partially "refundable" credit or rebate; that is, once the production verifies to the satisfaction of the state tax credit administrators that qualifying in-state expenditures have been made, a rebate check will be sent directly to the production company or its assignee (for financing purposes). California's program does not include a refund or rebate component; therefore, the credit must be claimed by a California taxpayer. Further, the credit is only transferable for independent films with a budget less than $10 million. To use the benefit of a nontransferable, nonrefundable credit, there are additional hurdles that a producer must overcome to monetize the amount of the anticipated credit and use the proceeds for production.

In addition to state tax incentives, steps can be taken at the local level to increase production Earlier this year, a plan to waive location fees in Los Angeles for any new television show's pilot and first season was passed by the City Council. The plan was sponsored by then-Councilman Eric Garcetti. Meanwhile, San Francisco has a production tax incentive program that offers qualified productions a refund of all payroll tax and city fees up to $600,000 per production.

Finally, local governments can do their part making California as film friendly as possible by making it easy to get film permits, lowering the cost of location fees, and assisting productions in cutting through government bureaucracy.

The economic benefits of film and television production are clear, which is why so many states offer competing incentive programs to draw production out of California. In its first five years, the California production tax incentive program has been effective in helping to stem the flow of runaway production. Its success warrants renewal and expansion, while cooperation and vigilance on the local level can further the goal of bringing production, and the economic benefits that come with it, back to California.

Michael S. Sherman *is a partner with Reed Smith LLP. He can be reached at MSherman@ReedSmith.com.*

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