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Subsidizing the stars

More than ever, the state is using tax breaks to attract favored industries — from life sciences to moviemaking

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Spring 2008

UPDATE: Since the spring issue of *CommonWealth* went to press, the Massachusetts Revenue Department released a report indicating the financial impact of the state's film tax credit could be substantial. The report said 88 movie projects were either completed or under development in 2006, 2007, and the first two months of 2008. The projects are expected to generate direct spending in Massachusetts of \$545 million and tax credits worth an estimated \$138 million. More than a quarter of the tax credits, or \$39.4 million, were the result of nearly \$158 million in payments to big-name stars and directors. The Revenue Department report hedged on whether the film tax credit was economically beneficial to the state. The report estimated payrolls for the 88 projects would yield \$18.6 million in employee withholding taxes, far short of the \$138 million cost, but said it was too early to project tax gains from the multiplier effects of the \$545 million in movie spending. The report also said: "Any estimate of the net economic and tax revenue impact of tax incentives needs to take into account the reduction in state government spending that occurs as a result of decreased tax revenue available for state programs, as well as other factors, such as how much in wages is paid to nonresident employees who spend that income in other states, rather than in Massachusetts."

Actual claims for film tax credits are trickling in to the Revenue Department and are expected to accelerate sharply in coming years as production intensifies. The Revenue Department report said credits worth \$17.5 million had been claimed so far. The report said 81 percent of the \$17.5 million in credits had been sold to third parties, mostly financial institutions. The average sale price was 84 cents on the dollar, meaning the third parties bought the credits at a steep discount and used them to shave roughly 16 cents off every dollar they owe the state. So far, the report said, no production company has sold its credit back to the state at 90 cents on the dollar. The Revenue Department said Massachusetts employment in the motion picture and video industries had fallen from an average of 5,214 in 2002 to 4,394 in 2006, before rebounding in the first nine months of 2007 to an average of 4,942. The report acknowledged that the employment data was preliminary and did not encompass movie jobs that would show up in job classifications not exclusive to the film industry. The data in the Revenue Department report was based on tax credit applications and applications for sales tax exemptions, which are sought before filming begins and typically a foreshadowing of a movie production's plans.



Shortly after he took office last year, Gov. Deval Patrick was asked whether his proposal to close corporate tax loopholes would hurt efforts to bring more jobs to Massachusetts.

"In my experience," the governor told the Greater Boston Chamber of Commerce, "companies don't make their investment decisions on the basis of the tax code. They make their decisions on the basis of whether there is an available, secure, sensible, broad-based labor pool and other conditions."

More than a year later, Patrick has discovered he was wrong: Companies do pay attention to a region's labor supply and its education and transportation infrastructure, but they do indeed make their investment decisions on the basis of the tax code.

Faced with company after company that has threatened to leave the state, Patrick has shown them the money. Evergreen Solar Inc., Organogenesis Inc., and Shire PLC have all received hefty packages of grants and tax breaks from the Patrick administration to expand here rather than in places like Singapore, Mexico, North Carolina, or Rhode Island.

Patrick is also courting the movie and life science industries with a new breed of corporate tax credit that transforms state taxpayers into business investors. The dollars are big and the return on the state's investment in terms of jobs and tax revenue is far from clear. The movie industry has pocketed \$23 million in tax credits so far, but its take is expected to soon top \$100 million a year. The Patrick administration is also preparing to commit \$100 million a year to life sciences for the next 10 years, with a quarter of the money going for tax incentives.

Regular tax credits reduce how much tax a company has to pay on its profits, but the new refundable, and sometimes transferable, tax credits go a step further by allowing unprofitable companies to convert their credits into cash. The more an unprofitable company spends on specified business activities in Massachusetts, the more money it gets back from the state.

Refundable tax credits originated as a way to help low-income people who often didn't earn enough money to take advantage of regular tax credits, but now they are being offered to unprofitable corporations backed by investors and venture capital firms. Refundable credits have become a way for the state to provide subsidies to a business or an industry without making a budget appropriation.

Massachusetts life science firms like the idea of refundable credits that can help them when they're in a startup mode. They grumble that nonrefundable tax credits are of little use because their corporate focus on research means it can take five to 10 years before they turn a profit and start paying taxes.

The caravan capitalists of the movie business also like the concept, bluntly saying that they go where the tax benefits are the best. Sam Weisman, a Massachusetts-based director, says the state benefits in the form of increased jobs,

economic activity, and tax revenue. "It's a home run," he says. "It's the biggest success story outside of the Patriots and the Red Sox this state has had in a long time."

But others are troubled by the state's use of the tax code to help select industries. Brian Gilmore, executive vice president for public affairs at Associated Industries of Massachusetts, a leading business group, says the new tax incentives represent a turning point for the state: "This is the first time the state has actually bought jobs."

GETTING IN THE GAME

In a world that's flat — meaning, according to New York Times columnist and author Thomas Friedman, that a business can put its operations virtually anywhere — location decisions can become high-stakes auctions in which states and nations bid for firms with tax breaks and infrastructure improvements. Massachusetts has never been a big player in this arena, but under former governor Mitt Romney, and now Patrick, the state has become far more aggressive.

Greg Bialecki, the Massachusetts undersecretary of economic development, says he always tries to sell life science companies on the state's attributes: Harvard and MIT, Boston's teaching hospitals, the state's success in attracting National Institutes of Health funding, and its workforce.

"But if you say there's no [incentive] package, you won't even be in the game," Bialecki says. "I guarantee you we are outbid and often grossly outbid by other places, and we have to do something. That has become the way the world works. They say, 'Tell us what you can do for us.'"

When Evergreen Solar of Marlborough decided to build a new manufacturing facility for its solar power products, the company fielded offers from several states and nations. Massachusetts ultimately won the bidding war by offering the company a package of grants, tax breaks, and low-interest loans. The package included state grants of close to \$24 million, tax breaks worth more than \$27 million, and land worth \$2.3 million at the former Fort Devens Army base for just \$1 a year.

Competition for a \$394 million pharmaceutical manufacturing plant being built by British drug maker Shire PLC was just as intense. Shire ultimately chose Massachusetts, but only after the state more than doubled its initial offer in response to competing bids from other states. The town of Lexington agreed to forego \$7.6 million in property taxes and Patrick, House Speaker Salvatore DiMasi, and Senate President Therese Murray personally promised an additional \$40.5 million in state help.

Organogenesis, a Canton-based maker of living tissues that can be used to heal wounds, originally looked to build a new headquarters and manufacturing plant in another state, but it settled on Massachusetts after Patrick administration officials pledged to insert a provision in the life science legislation that would exempt the company from a key provision of the state tax code and shave as much as \$5 million off its annual tax bill.

"Really, it just came down to the tax climate," says Geoff MacKay, the company's chief executive.

The life science industry's first taste of a refundable tax credit went to an unlikely recipient. Bristol-Myers Squibb, a pharmaceutical company that reported \$2.1 billion in profits last year, received a state package of tax and infrastructure benefits worth more than \$80 million in 2006, when it decided to build a manufacturing facility at Devens. Included in the package was a 5 percent refundable "economic opportunity area" credit that was approved by the Legislature. For every dollar Bristol-Myers Squibb invests in its plant, the state pays the company 5 cents. State officials say the credit should net the company at least \$33 million.

The Patrick administration is now preparing to offer two refundable credits to life science companies certified by state officials. The first is an investment tax credit raised from 3 percent to 10 percent, or as high as 12 percent in certain areas of the state. It covers investments in buildings and equipment. The second is the 10 percent research and development tax credit. Life science companies will also be allowed to carry operating losses forward for 15 instead of five years and seek state reimbursement for all fees paid to the US Food and Drug Administration for drug approvals.

The life science tax credits are capped at \$25 million a year, but pressure is likely to build to increase that amount. The Revenue Department estimates that just the two refundable tax credits in the legislation would cost the state \$136 million next year.

Nearly all of the tax code changes were sought by the life science industry at a time when one of the Patrick administration's top economic development aides was secretly talking with the Massachusetts Biotechnology Council about taking the group's top job. According to reports in the *Boston Globe*, Robert Coughlin began talking with council officials about the job opening on June 11 but didn't tell his government superiors until July 24, after work on the life science legislation was completed. Coughlin was named president of the Biotech Council in August. The state Ethics Commission is currently investigating his actions.

State Sen. James Marzilli Jr., an Arlington Democrat, says politicians give lip service to the idea that private markets are best at allocating resources and capital, but then act on just the opposite principle by offering tax credits that turn taxpayers into corporate investors. "It's a very worrisome trend," Marzilli says. "The refundable credits are particularly worrisome. They're creeping disasters."

BOSTON BECOMES A BACK LOT

While the tax incentives being offered to life science companies are designed primarily to keep them in Massachusetts, the credits offered to movie producers are designed to lure them here. Supporters pushed for credits that would grab a Hollywood mogul's attention, and they succeeded.

The state's film tax credit is one of the most lucrative in the nation, literally subsidizing the salaries of the stars who come here to make movies. It offers a 25 percent credit on all payroll and production expenditures in Massachusetts and exempts most of a film company's purchases from the state's 5 percent sales tax. That is, for every dollar a production company spends, it receives a credit worth 25 cents that can be converted into cash, either through a refund from the state or by selling it to anyone who owes taxes in Massachusetts.

"It's free money," says John Hadity, a former Miramax executive who now runs a New York consulting business that helps studios maximize the tax credits states are showering on them. "Credits have become the math for making films."

For movie studios, the credits offered by states just keep getting better. Until the late 1990s, most states offered token benefits to movie studios, usually help in finding locations to shoot. But in 1997 the Canadian government adopted a tax credit. The Canadian provinces quickly followed suit, Louisiana jumped into the game in 2002, and today more than 30 states offer some sort of film tax credit.

Connecticut's 30 percent credit is the highest, but lawmakers in Michigan are considering raising their credit to 40 percent. New York, stung by movie losses to the New England states, is talking about beefing up its credit. Massachusetts even leaptfrogged itself. The state's initial film tax credit, which took effect in 2006, capped the maximum credit per production at \$7 million. Hollywood studios let it be known that they might not film big-budget pictures in Massachusetts because the cap would force them to leave money on the table, so Beacon Hill lawmakers quickly changed the law to remove the \$7 million cap and reduce the minimum spend per picture from \$250,000 to \$50,000.

"You've got to keep up," says state Rep. Brian Wallace of Boston, who has sponsored many of the state's film tax credit bills. Wallace says at some point the credits "will reach a critical mass and you can't go any higher," but he doesn't know if that level has been achieved yet.

Prior to passage of the state's film credit, the number of principal shooting weeks in Massachusetts, a key barometer of film industry activity, averaged six per year between 1996 and 2005. Movies with stories set in Massachusetts, like *Fever Pitch*, *The Perfect Storm*, and *The Departed*, were filmed primarily elsewhere. Only 7 percent of the \$90 million *Departed* budget was actually spent in Massachusetts, according to the Massachusetts Film Office.

But Boston quickly became a back lot for Hollywood after the state's film tax credit took effect in 2006. Principal shooting weeks in Massachusetts more than tripled to 20 in 2006, shot up to 55 in 2007, and are on pace to go far above 100 this year. 21, the just-released film about card-counting MIT students, spent 71 percent of its \$42 million budget here. Films with stories set in Paris (*Pink Panther 2*) and Virginia (*The Box*) are now being shot in Massachusetts.

Steve Elzer, a vice president at Columbia TriStar Motion Picture Group in Los Angeles, which produced *Pink Panther 2*, was asked how important the tax credit was in shooting the movie here.

"Critical," he replied.

Movie companies aren't the only ones benefiting from the film tax credit. Christine Peluso, a principal at Tax Credits LLC in Piscataway, New Jersey, helps film companies sell their tax credits. She says most of the buyers tend to be banks and insurance companies with multi-state tax liabilities who buy the credits at a discount to cut their tax bills. "They save a lot of money," she says.

Joseph B. Darby III, a tax attorney at Greenberg Traurig in Boston, is probably one of the few individuals to buy a Massachusetts film tax credit. One of his clients filmed a horror movie called *Shuttle* at the Worcester Airport, and Darby bought some of the tax credits, paying 85 cents for every dollar's worth. The transaction provided the movie's producers with cash and Darby with a 15 percent tax reduction.

The same opportunity may soon become more widely available. Taxcred.com, a website aspiring to become the eBay of transferable tax credits, is preparing to launch soon.

ESCAPING SCRUTINY?

The cost of tax incentives gets surprisingly little attention in Massachusetts. They are relegated to an obscure section of the budget and, once enacted, rarely reviewed. Yet the Revenue Department says the fiscal effects of most tax incentives are identical to those of a direct government expenditure.

The total cost of the state's economic development tax expenditures — the revenue either paid out or foregone by offering tax breaks to companies — is expected to hit \$1.5 billion this year, an all-time high. According to the Massachusetts Budget and Policy Center, a liberal-leaning think tank in Boston, the cost is up 22 percent in inflation-adjusted dollars from the previous peak in 2000.

State Rep. Daniel Bosley of North Adams, House chairman of the Legislature's Committee on Economic Development and Emerging Technologies, says he has real concerns about offering tax breaks to specific companies or industries, effectively picking winners and losers. But he says there are always exceptions. "Tax credits are an investment in firms," he says. "You hope that if we invest in them, they will invest in us."

But there's often little follow-up to find out whether the investments pay off. Michael Widmer, president of the nonpartisan Massachusetts Taxpayers Foundation, says calculating a tax credit's impact on job growth, economic activity, and tax revenue is very complex. "Do credits work?" he asks. "The answer is, nobody knows. It's very hard to prove they do or they don't."

A couple of examples prove Widmer's point. In the late 1990s, then-House Speaker Thomas Finneran and New England Patriots owner Robert Kraft played a game of chicken over how much financial support the state should provide for a new football stadium. Kraft threatened to move the Patriots to Connecticut, which was offering him hundreds of millions of dollars, but he ultimately built the stadium himself in Foxborough and the state provided \$70 million in infrastructure improvements. Settling for less cash doesn't seem to have hurt the Patriots or Kraft. The team has won three Super Bowls and is widely regarded as one of the top franchises in the National Football League.



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To take another example, in the mid-1990s the state tried to keep local defense contractors, mutual fund companies, and manufacturers from leaving the state by changing the formula for determining how much of a firm's profit would be taxed in Massachusetts. The old formula derived Massachusetts taxable income by calculating the percentage of the firm's plant, payroll, and sales in Massachusetts. The new formula used sales only, which benefited companies that sold most of their products outside the state and gave them a financial incentive to add payroll and plants here.

While that tax change is costing Massachusetts nearly \$300 million this year in lost tax revenues, it's unclear how much benefit accrues to the state. Manufacturing employment held steady at roughly 412,000 jobs between 1995 and 1998, but since then has dropped by 28 percent, or 116,000 jobs. Raytheon Corp., which at the time of the tax cut was the state's biggest employer, started reducing its payroll in Massachusetts within months of the tax change. It subsequently restructured its business, making any job analysis difficult.

FMR LLC, the corporate parent of Fidelity Investments, fulfilled its commitment under the legislation to increase its Massachusetts payroll 5 percent a year for five years, but then began reducing employment in the state and expanding elsewhere. A Fidelity spokesman says the Boston-based company employed 18,000 people in 1995, with 9,024 jobs, or half the total, in Massachusetts. By 2000, the number of Fidelity employees in Massachusetts had increased to 14,775. Today, the company has 46,000 employees, but the number in Massachusetts has dropped to 12,600, or little more than a quarter of the total.

Nearly 60 percent of the Fidelity workforce reduction in Massachusetts between 2000 and today resulted from the sale of businesses, primarily the Community Newspaper Co. in 2001, but the remainder of the jobs, close to 900, were just moved out of state, many to neighboring Rhode Island and New Hampshire.

'WE NEED TO EXTEND OUR LEAD'

Kraft was skewered as a "whining millionaire" for demanding more money from the state, but Beacon Hill lawmakers have embraced the life science and movie industries as deserving of the state's help. The major powerbrokers on Beacon Hill — the governor, the speaker, and the Senate president — can't seem to do enough for the two industries.

Speaker DiMasi, at the unveiling of the House's life science legislation, said Massachusetts was locked in a struggle with North Carolina, California, Ireland, and Singapore for the industry. "We need to extend our lead and we need to expand our dominance," he said.

Gov. Patrick earlier this year pledged to life science industry officials that he wouldn't let them go the way of the old Route 128, which was known as the state's technology highway until many of the companies that lined the road went under or were sold. "I refuse to let that happen again," he said, neglecting to mention that many of the Route 128 companies bet on the wrong technology — the minicomputer instead of the personal computer.

The cheerleading for the film industry has been even more enthusiastic. Murray, who visited the set of *Pink Panther 2*, calls movie production a state economic success story. DiMasi, in a letter to House members in March, said Massachusetts was becoming the "Hollywood of the East."

While the prospect of casinos stirred lively debates on Beacon Hill and intense media coverage, the votes for life science and movie tax credits were ho-hum affairs. The film tax credit passed the House 147-4 and the Senate approved it by voice vote. The House voted 134-13 for the life science legislation and the Senate passed it by a margin of 32 to 4.

Stephen Mulloney, director of policy and public affairs for the Massachusetts Biotechnology Council, says he was surprised at how fast the life science tax credits passed. "We thought it would be a decade-long exercise because tax laws are hard to change," he says.

What ultimately carried the day on both the film and life science tax credits was the promise of jobs and economic expansion. In his State of the State speech in late January, Patrick said the film tax credit had attracted 10 movies and \$200 million in new economic activity to the state in 2007. He also predicted the life science legislation would create 250,000 new jobs over the next decade.

The life science job estimate represents twice as many jobs as the state as a whole created over the previous 10 years. Analysts outside the administration say it's unlikely that many jobs will be created. Peter J. Abair, director of economic development for the Massachusetts Biotechnology Council, says "it would take a best-case scenario."



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Patrick declined to be interviewed, but Daniel O'Connell, his secretary of housing and economic development, said the job projections are attainable. He said the projection assumes the life science industry will more than double in size over the next decade, rising from 74,000 jobs to more than 155,000 jobs. Another 169,000 jobs will be created to service the life science sector. That's a multiplier of two service jobs for every life science job, a fairly conservative assumption given that many studies use multipliers of three and five.

"We do think it's doable," O'Connell says. "Is it impacted by the national economy? Yes, but we think we're pretty well-positioned. We don't use the 'R' word around here."

Bialecki, the state's economic development czar, says the life science refundable tax credits will offer a good return on investment. He says they may cost the state \$20,000 to \$30,000 per job, but they will pay for themselves and start bringing in net new tax revenues in five to 10 years.

O'Connell, however, says he has reservations, which is why the administration favors a \$25 million cap on incentives and backs provisions that would force companies to give back the money they receive if they don't produce the jobs they promise. "We think we need some stick with this carrot-and-stick approach," he says.

A NONSTOP SHOOT

The job base of the state's film industry is nowhere near as big as life sciences. A 2006 benchmark report indicated 2,600 people were employed in Massachusetts motion picture production in 2004. The new business spawned by the film credit has created jobs, but it's difficult to gauge how many more because the jobs are sprinkled across many industry categories and last only as long as the project is shooting.

Chris O'Donnell, business manager for Local 481 Studio Mechanics, which represents grips, set designers, and sound engineers, says he has 350 members in Massachusetts, up 40 percent, or 100 jobs, since the film tax credit took effect.

Tom Williams, who has been working as a sound engineer in Massachusetts since 1984, says that prior to passage of the tax credit he had to string together a series of jobs in several mediums. Now he works almost nonstop in feature films. "It's every day, every week, full-on until mid-August at least," he said in a phone interview from the Rhode Island set of *The Clique*. After that film wraps, he goes to work in Massachusetts on *The Mall Cop* starring Kevin James and then the Bruce Willis film *The Surrogates*.

The demand for film workers is so strong right now that some industry officials are circulating a proposal calling on the state to fund a worker training effort for the movie industry. "A shortage of skilled workers could choke off the flow of large and small projects," the proposal says.

Film industry officials are also laying plans to build sound stages in Massachusetts, which they say would keep more movie money and jobs in the state. One bill pending in the Legislature would give sound stage developers a 20 percent tax credit on their investment. Like the film tax credit, the sound stage credit could be sold to a third party and converted to cash.

John MacNeil, president of Moody Street Pictures in Waltham, says the film business creates good-paying jobs, promotes tourism, and causes little demand for public services like schools. "This is a clean business that will come in, hire a bunch of people, drop a whole lot of cash, and leave," he said.

Dona Sommers, executive director of the New England branch of the Screen Actors Guild and the American Federation of Television & Radio Artists, says the film credit is doing what it was supposed to do. "Movie productions only get the credit if they spend the money here," she said. "How can we be losing?"

MEASURING THE BENEFITS

Movie studios were reluctant to share their financials, but the state Revenue Department supplied spending numbers for what it described as a typical big-budget film shooting in Massachusetts. The film spent \$8 million employing roughly 200 people for 46 days. It also spent \$12 million on production expenses, including star salaries of \$1.6 million. The Revenue Department offered no tax revenue estimates, but such a production would pay the 5.3 percent withholding tax on wages (roughly \$509,000), hotel taxes on rooms for stars and crew, and possibly some other minor taxes. The total would come nowhere near the \$5 million credit the film would receive.

Supporters of the film tax credit say the money spent by a movie in Massachusetts keeps reverberating through the economy as those who get paid spend their money on goods and services that generate additional tax revenue. But some analysts who have studied this ripple effect say film tax credits cost states more money than they bring in.

"Film tax credits do not 'pay for themselves' by indirectly generating additional corporate income, sales, and property tax revenues," wrote Darcy Rollins Saas, a policy analyst at the New England Public Policy Center at the Federal Reserve Bank of Boston, in an October 2006 article.

In March 2005, Louisiana's Legislative Fiscal Office concluded that state's film tax credit was costing taxpayers just under \$50 million a year. The study said the credit attracted movie productions that created jobs, boosted incomes, and tax revenues, but not enough to offset the cost of the credits.

"I really tried to make every assumption I could in favor of the program, but it's going to cost you," says Greg Albrecht, chief economist at the Louisiana fiscal office. "It's really a government subsidy program."

Most of the economic activity generated by the film credit is new, but not all of it. WGBH-TV (Channel 2), a nonprofit public television station, films a number of television series at its Brighton studios that qualify for the film tax credit. The 2006 season of *Design Squad*, a show aimed at budding teenage engineers, cost \$2 million to produce, of which all but \$500,000 was spent in Massachusetts. WGBH spokeswoman Jeanne Hopkins said *Design Squad* should generate a state tax credit of about \$260,000, which will net the station about \$235,000 in cash after the credit is sold to a third party and middleman expenses are deducted. Hopkins said the money will be plowed into more productions, easing fundraising

pressure at the station.

Officials in Connecticut and Rhode Island are scrutinizing their film tax credits more closely because of concerns that the economic benefits are not as great as once thought. Critics also complain that tax credits for the movie or life science industries are diverting money away from more pressing state needs. "They become a hidden form of spending," says Ann R. Markusen, a professor at the Hubert Humphrey Institute of Public Affairs at the University of Minnesota.

Jean Ross, executive director of the California Budget Project in Sacramento, says that her state has so far resisted passing tax incentives for the Hollywood film industry. "There are a lot of questions about whether we provide the wealthiest corporations in California a tax break while we're cutting \$4 billion out of our public schools," Ross says. "It really comes down to a question of where are your priorities."

Nicholas Paleologos, executive director of the Massachusetts Film Office, has heard all of the criticism of the film tax credit and even accepts some of it. But he says he believes the true cost of the film credit is minimal. Doing some back-of-the-envelope calculations, he says the state is spending probably about 10 cents for every dollar of film investment it attracts.

"You are making an expenditure to generate some economic activity," he says. "Either you think that's a good idea or you don't."