

# Could a single federal tax credit end the economic war among the states?

By Schuyler M. Moore

IT'S TIME TO FACE some hard facts of life:

► California is on the precipice of bankruptcy.  
► The Golden State has the second-highest unemployment rate in the country, coming in just behind Michigan with an "official" rate of more than 11% and an unofficial rate of nearly 20%, if you count those who work part time or have just given up. And guess where much of that unemployment is coming from: The entertainment industry, one of California's largest employment sectors.

► Other states are stealing California's entertainment employment with a race to the bottom in tax-credit giveaways that are mind-numbing in their generosity. The ugly truth is that the "beggar thy neighbor" competition among the states has led them to give away a lot more than they're getting, increasing their already massive deficits. We thus have a lunatic system in which states are competing against one another, driving them insolvent, rather than the country competing as a whole against the rest of the world.

► There is still so much production in California that the state can't compete on equal footing in this tax-credit flea market, as even a modest credit applied to the massive remaining production in California would tip it into bankruptcy. The best the state can do is pretend to compete, which is why it recently passed an anemic, deferred-production tax credit that looks good in news stories but in practice is a paper tiger. And in most cases, the credit is unusable because it is not refundable

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and generally can only be used against the production company's California tax liability, which often is zero. Even when the credit can be used, it is deferred until 2011, and given California's history of "gotcha!" tax changes and its current fiscal problems, it would not be surprising if California deferred further use of the tax credit "for a little longer. ..."

► The federal government is fiddling while Rome burns, merely waving at the problem of runaway production with Tax Code Section 181, which permits a deduction for the first \$15 million for films shot in the U.S. The problem is that this deduction is a "passive loss" for individual investors that only can be used against "passive income" (basically income from real estate, and good luck with that these days), and even if the deduction is taken by a corporation with taxable income (a rarity in this time of mounting tax losses), at most it accelerates the deduction by about one year. With interest rates at about 2%, this benefit of one-year acceleration doesn't even amount to enough to buy stamps to write home about. The worst part is that the deduction is not assignable, so it can't be used to generate actual financing without some fairly tricky footwork. The result is that it is almost useless as a practical matter.

So what's the solution? Easy. It is time for all the states to band together, stop the self-defeating madness and request the federal government to convert Section 181 into a useful 10% tax credit — instead of a deduction — for U.S. production costs. And it must be assignable in order to provide actual financing for produc-

tion, which is what really is needed.

As part of implementing this tax credit, the federal government should use its power under the Commerce Clause to pre-empt all state laws (and don't let Puerto Rico sneak away) that give tax credits for production. That way, the states would be saved from their self-inflicted immolation, and they could go back to competing for production based on services, infrastructure and locations — just like in the good ol' days. We could go back to seeing ads to

shoot in Wyoming because of its sweeping vistas rather than ads for shooting in Connecticut because of its sweeping tax credits.

Yes, California might benefit disproportionately from federal preemption of state laws granting production tax credits because it could again compete for production on an equal footing based on the services and facilities here, but a rising tide raises all ships, and it is better for all the states to start floating again than leak from a battle of excessive tax credits.

And I thought the Civil War resolved once and for all that America is one country, undivided, whose interest was of a unified national character, not a loose federation of warring fiefdoms.

If we are going to seriously battle runaway production to foreign shores, we had better stand together and adopt a national plan to counter this scourge. And the best plan to do that is with a single federal tax credit that is assignable (to permit badly needed financing for production) or, barring that, is at least refundable.

One way or the other, we better do something intelligent — and soon — before the states nibble themselves to death.



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