Much to the chagrin of moviemakers, the financing available for independent films has been drying up for the past few years. The insurance-backed funding schemes that were the rage for a while have disappeared after huge claims were made and protracted litigation ensued. Even top producers have difficulty securing financing based on pre-sales—and those funds are often contingent on securing domestic theatrical distribution. Gap financing is in short supply, too, as banks have grown wary of lending money on the basis of projections. At most, a producer might be able to secure a gap loan for 20 percent of the budget in today's climate. Raising money from equity investors has always been challenging, but when the economy is sluggish and high-net-worth individuals have suffered years of losses, it can seem almost impossible to raise funds for a risky investment like film. SO WHAT'S A MOVIEMAKER TO DO?

SOFT MONEY IN HARD TIMES

THE INTERNATIONAL HUNT FOR PRODUCTION INCENTIVES IS ON

by Mark Litwak, Esq.

INCREASINGLY, AMERICAN PRODUCERS ARE EMULATING their European brethren's long-held tradition of cobbling together government subsidies and incentives to fund their projects. This is a new arena for Americans, who are used to operating in a free enterprise system without any government support. Indeed, the federal government provides no production incentives, tax breaks or other specific support for moviemaking (with the exception of some crumbs thrown to public television producers and meager grants from the National Endowment for the Arts). This could change if Congress enacts legislation to combat runaway production, but with the federal budget deficit at an all-time high, it's doubtful that Congress will enact substantial tax breaks anytime soon. Due to its own severe budget crisis, the state of California suspended all funding for its Film California First incentive program in 2003.

American moviemakers are increasingly searching for incentives and other soft monies that may be available to them. Many states and several countries have begun to realize that every dollar spent locally has a multiplier effect on the economy. And a popular motion picture can expose millions of people to local attractions and build tourism. A film like *Whale Rider* will always be more effective than a paid commercial, if the aim is to illustrate the beauty and culture of New Zealand.

At one time, producers who took advantage of production incentives were considered marginal players. Today, major studios and many successful producers *rely* on incentives. A producer would be foolish not to consider the incentives available when selecting a location. The incentives most readily available to Americans are those that only require that you bring your shoot to a location where you'll spend your budget. These deals are usually open to all producers—regardless of nationality or content of the picture. Examples include the Canadian Production Services Tax Credits, the British Sale-Leaseback scheme and the German Film Funds. Domestically, more than 40 states offer film incentives.

Location-based rebates are given to producers based on the amount they spend in an area. While the benefit may not be paid until after completion of the production, certain banks may loan the producer funds with the anticipated benefit as collateral. Canada, Luxembourg, Iceland and Australia offer such rebates.

Other programs reward film investors. The German Film Funds, the Netherlands' CV system of limited liability partnerships, the French Soficas and the U.K. Sales-Leasebacks are examples.

A few governments, like in the U.K. and Italy, offer producers loans with favorable terms. Germany has them at the regional level. The European Investment Bank, a European Union-backed institution, offers loan guarantees. Here in the U.S., New Mexico has a program that loans funds to producers without interest.

France, Spain and the Nordic countries all have schemes in which a small slice of box office revenue is siphoned off to encourage future production. The EU's Media Plus program uses box office revenue to assist distributors and exhibitors.

Sometimes producers are offered reduced prices for locations, facilities, use of police and permit fees. New York City, for example, doesn't charge for permits and provides free police traffic control.

In addition to incentive programs, producers should consider other benefits that can arise from moving your production. In Eastern Europe, South Africa and China, the wage scale is so low that crews and extras can be hired for a fraction of the cost of those in the United States. Likewise, food, lodging and construction costs can be a bargain. If a producer can hire crew members or book a hotel for 20 percent of what those items would cost in the U.S., then the producer is receiving a benefit equivalent to an 80 percent subsidy. The moviemaker also avoids the burden of completing complicated paperwork and incurring legal and accounting fees. But savings may be offset by increased travel costs, which may be negligible for a moviemaker shooting in his own community.

ILLUSTRATION BY MARTY BRAUN

To be eligible for some incentives, the film may need to employ cast members from certain countries. It is not unusual for an American producer to shoot abroad and bring along one or two American stars to enhance the value of the film. These American stars are almost always members of SAG, while the locally employed actors are not (although the local actors may have membership in a local union). SAG's Rule One does not allow SAG members to work for producers who are not SAG signatories. In the past, SAG didn't enforce this rule when a SAG actor worked abroad. As of May 1, 2002, however, SAG has announced that it intends to strictly enforce Rule One, threatening disciplinary action against any SAG actors that work for non-signatory companies. This will force producers who are shooting abroad to either employ exclusively non-SAG actors or become a SAG signatory with its accompanying obligations, including rules on working conditions and contributions to pension and health insurance payments.

When parties from different nations co-produce a film, they need to carefully consider the tax consequences of their collaboration. Careful structuring of the collaboration may significantly reduce the tax burden on the parties. For example, a co-production between two parties may be considered a partnership for tax purposes. As a partner engaged in a trade or business in the United States, a foreign national may be subject to U.S. income tax, and the partnership may be required to pay withholding tax on the foreign national's share of income. Since the U.S. tax rate may exceed what the foreign national is taxed in his country, this may be an undesirable consequence. If the deal is fashioned so that the foreign investor retains non-U.S. distribution rights and has no U.S. trade or business, it may avoid paying U.S. tax from income derived from the film outside the U.S.

The currency exchange rate is an important factor whenever shooting abroad. Canada and South Africa are attractive locations because the American dollar is strong compared to the local currency. On the other hand, moving to a distant location may have drawbacks. If your camera breaks down in a remote location, it may take days to have a replacement shipped in. The availability of experienced and talented crew members varies greatly, as well.

By international treaty, some countries encourage their nationals to collaborate with others by allowing them to aggregate incentives. Canada has treaties with 60 countries. These agreements allow their producers to pool financial, creative and technical resources with other nationals. The treaties lower the requirements that normally must be met for each producer to access incentives in their home country, and may reduce administrative burdens.

It bears noting that the United States is not a party to any international co-production treaties. Nevertheless, U.S. moviemakers can enter into co-production agreements with foreign nationals. Even if an American producer is fully financing a film, a knowledgeable resident line producer can be invaluable in securing the best deals and ensuring compliance with local rules. An American production that features a local director or star may enhance the commercial value of the film in that country.

INCENTIVE PROGRAMS IN THE UNITED STATES

NEW MEXICO OFFERS PRODUCERS a choice of two incentives. A gross receipts tax deduction allows moviemakers to avoid sales tax for certain production costs, including the cost of a script, salaries for talent, construction, wardrobe, sound, lighting, editing, location fees, rental of facilities and equipment (not including lodging) and rental of vehicles or catering. Sales tax is 5 to 7 percent, depending on the location where the sale is made. Moviemakers can obtain NTTC certificates so that the sales tax is not assessed by suppliers.

Alternatively, a moviemaker could elect to receive a 15 percent film production tax credit. This credit applies against the moviemaker's New Mexico income taxes. This applies to New Mexico-based production expenditures that are taxable in New Mexico. In order to qualify, production companies need to register with the New Mexico Film Office and they may only take advantage of one incentive for each purchase.

New Mexico waives location fees for the use of state-owned buildings. There are approximately 800 such buildings, including the now shuttered state penitentiary, a 1940s-era, maximum-security prison facility.

The state is willing to invest or loan funds to (continued on page 112)

Soft Money in Hard Times

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producers meeting certain criteria. Under the New Mexico Film Investment Program, up to $7,500,000 can be invested in a NM film private equity fund or NM film project. The motion picture must be substantially shot in the state, needs to have a distribution agreement in place with a reputable company, employ mostly state residents as crew (60 percent) and post a completion bond. The amount of the state's equity participation is negotiable depending on how risky the project is. If a loan is given, the state can take an equity investment instead of charging interest.

The state is not willing to take much risk. First-time producers are not acceptable unless they are affiliated with seasoned producers who are actively involved. The state usually must be in first position for recoupment of its capital. Indeed, New Mexico's requirements are not much different from what a bank would require, which means that most low-budget indie moviemakers will not qualify. The primary advantage is that New Mexico is willing to accept back-end profit participation rather than charge interest for the use of its money.

Hawaii recently enacted some very impressive and generous tax incentives. Hawaii's high-tech investment tax credit provides a 100 percent return on cash investments in a qualified high-tech business (QHTB) over five years (35 percent credit in the first year of investment, 25 percent in the second, 20 percent in the third and 10 percent in the fourth and fifth years following). Qualified research activities include performing arts products such as motion pictures. The credit is designed to give a 100 percent return for investments up to $2 million per year, per taxpayer. The credit applies against Hawaii income tax liability only. The credit can be taken by individuals or corporations paying Hawaii income tax, and by banks and insurance companies against their franchise and insurance premium tax.

Moreover, if money from outside Hawaii is invested, the tax benefits can be allocated in such a manner so that the Hawaiian investors can obtain more than a 100 percent return. So for example, if a Hawaii investor put up $500,000 and an Arkansas investor put up $500,000, the parties could agree to allocate all the tax credits to the Hawaii investor (since the Arkansas investor doesn't pay taxes in Hawaii they are worthless to him anyway). Under this scenario, the Hawaii investors could receive a 200 percent return over five years. In return, the Arkansas investor could be given preferred recoupment or a greater share of the profits.

"The Hawaiian incentive is the most impressive effort of any state, by far," says producer Doug Mankoff (*The Big Empty*), who is opening a Hawaiian subsidiary. "A program that eliminates financial risk for Hawaiian investors, and gives the other investors a priority return, is tremendously attractive to producers."

The production entity would be required to spend 75 percent of the budget in Hawaii. In order to qualify, companies need to stay in business in Hawaii for at least five years and should have copyright ownership of the picture. The downside of shooting in paradise is that it's more costly than many other locations, it's a union state and indies will likely need to negotiate with IATSE and the Teamsters.

Two movies have been made with this incentive: *Blue Crush* and *The Big Bounce*. The grant of tax credits for *Blue Crush* was quite controversial as this Imagine/Universal production was planning to shoot in Hawaii anyway. They received an estimated benefit of $15 to $18 million. The purpose of this law was to build movie industry infrastructure in Hawaii. Imagine and Universal shot the picture and departed without putting down any roots. The tax department will no longer issue tax comfort rulings on one-picture deals.

INTERNATIONAL INCENTIVE PROGRAMS

Canada has been very successful in luring American productions to shoot in Canada. Toronto and Vancouver have a deep reservoir of skilled and experienced crew members, so numerous productions can shoot simultaneously. A favorable exchange rate with the U.S. dollar lets American producers stretch their resources by buying goods and services for less.

Canada offers a variety of programs designed to support both Canadian and foreign producers. A distinction is made between Canadian content films, which receive a generous tax credit, and those films which do not possess Canadian content, which are eligible for a substantial but lesser credit. Both programs are jointly administered by the Canadian Audio-Visual Certification Office (CAVCO) and the Canadian Customs and Revenue Agency (CCRA). Producers cannot receive benefits under both programs simultaneously, but they may combine these production incentives with those offered by Canada's provincial governments.

To be eligible for Canadian content incentives, the company must be owned or controlled by Canadian citizens or permanent residents. Either the director or screenwriter and one of the two highest paid actors must be Canadian. The production must also earn at least six points based on key personnel being Canadian. Seventy-five percent of production costs must be paid to Canadians. The company will receive a tax credit of 25 percent of labor expenditures (which usually amounts to 12 percent of total production costs). Labor expenditures include payments to non-Canadians for services provided in Canada.

For productions that do not meet the criteria for Canadian content, the Production Services Tax Credit is available. This is a federal refundable tax credit to promote production in Canada. The applying corporation can be a production services company that has contracted with the copyright owner. Americans can benefit from this credit, but it only applies to movies with budgets of at least $1 million Canadian (approximately $678,000 U.S.). Certain financiers will advance monies to a producer on the basis of an expected tax credit.

Although American producers do not benefit from any co-production treaty, Americans can qualify as a certified co-venture that is eligible for enhanced broadcast license fees as Canadian programs. To be certified, the co-venture must meet the six point and 75 percent spend requirements for Canadian content films. Canadian provinces provide additional incentives.

The United Kingdom provides many types of support to encourage moviemaking. The government provides funds for education and training, lottery monies for production and tax credits, as well as participating in European programs such as Media Programme that provides additional resources.

The British Government set up the Film Council in April 2000 to provide public funding to assist British film production. The Film Council has supported such recent films as *Gosford Park*, *Bloody Sunday* and *The Magdalene Sisters*. *Bend it Like Beckham*, for example, received £1 million from the lottery. **MM**

A listing of production incentives is available at Entertainment Legal Resources (www.marklitwak.com). As the rules and regulations governing incentives and subsidies frequently change, contact the appropriate agency to obtain detailed requirements.