Runaway Film and Television Production: Carrots, Sticks, & International Tax Reform

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“Runaway” Film and Television Production: Carrots, Sticks, & International Tax Reform

by PAUL BATTISTA*

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I. Introduction

"Runaway" film and television production is a public policy issue that has been targeted for reform with the goal of its eradication, a goal that has not been achieved. The discussion has framed the issue as one relating to international trade policy and labor policy, and as a result proposals to eradicate the problem have been focused on these areas. This article takes the position that runaway film and television production is an international tax law issue that should be examined within the framework of U.S. international tax policy. In general, the U.S. international tax laws require reform because they subsidize U.S. businesses in amounts that are detrimental to the fiscal stability of the United States in addition to being inefficient and inequitable. Motion picture tax incentives ("MPIs") provided by other countries to induce runaway film and television production exacerbate the existing inefficiency, inequity, and fiscal instability of the U.S. international tax laws, and should be immediately addressed by amendments to U.S. international tax laws. My proposals will make the U.S. international tax laws more efficient and equitable, as well as create more tax revenue for the United States, while at the same time will help eradicate runaway film and television production.

Numerous studies and articles regarding U.S. international tax laws have concluded that the present laws affecting U.S.-based multinational corporations ("MNCs") are too generous to these taxpayers, inefficient, unnecessarily reduce U.S. tax receipts, and reduce tax equity. Therefore, they should be reformed. Although

1. See infra Part II.B. For purposes of this article, "runaway" film and television production refers to projects that go to other countries rather than from one U.S. state to another U.S. state; see also MARTHA JONES, MOTION PICTURE PRODUCTION IN CALIFORNIA, CAL. RESEARCH BUREAU 2 (2002) for a definition of "runaway" production.
2. See infra Part IV.
3. See infra note 5.
4. See infra Part VI.
there is unanimity regarding the need to reform the U.S. international tax laws, the numerous reform proposals have not produced a consensus as to a specific overall reform design. To this point, reforming the U.S. international tax laws has been a piecemeal process. Certain inefficiencies are identified and specific laws are enacted to address those specific issues.

These issues have been formally recognized by the Obama Administration in The President's Framework For Business Tax Reform as follows:

America's system of business taxation is in need of reform.... As a result of [the] combination of a relatively narrow tax base and a high statutory tax rate, the U.S. tax system is uncompetitive and inefficient. The system distorts choices such as where to produce, what to invest in, how to finance a business, and what business form to use. And it does
too little to encourage job creation and investment in the United States while allowing firms to benefit from incentives to locate production and shift profits overseas.\(^8\)

Part II of this article reviews the background of runaway film and television production, describes the parties involved, and explains why the issue is a tax issue. Part III examines the potential government responses to public policy issues in order to establish a clear understanding of the issues. Part IV analyzes the actions that the U.S. federal and state governments have taken in their attempt to eradicate runaway film and television production. Part V provides background on the U.S. international tax laws and tax avoidance. Part VI offers U.S. international tax law amendments that will make U.S. international tax laws more efficient and equitable and will create more tax revenue for the United States, while contributing to the eradication of runaway film and television production.

II. Runaway Film and Television Production

Runaway film and television production has been defined as "the migration of the production of U.S.-developed films to countries outside the United States..." and has been the subject of U.S. government hearings, federal and state legislation, fourteen academic articles and six major studies.\(^9\) Since the articles and studies have

8. \textit{President's Tax Reform, supra} note 5, at 1.

\begin{itemize}
  \item I rise to discuss the U.S. Independent Film and Television Production Incentive Act of 2001. . . . This is a bill designed to address the problem
of runaway film and television production which is a major trade-related issue which costs our nation billions of dollars each year.


The purpose of H.R. 4736, the Independent Film Small Business Job Creation Act, is to help create jobs in the United States by encouraging investment in film production here at home.... In summary, this bill would address runaway productions by encouraging investment in independent film projects in the United States.

extensively addressed the who, what, where, when, and how, this article will summarize the basic points necessary for a general understanding of the issue, while more fully exploring those points most relevant to the arguments herein presented.

A. Factors in Choosing a Production Location

The film and television industries are similar to other U.S. industries that have decided to produce or manufacture a product in a country other than the United States; the computer and electronic industry and the apparel industry are good examples. Since, however, film and television production contains an artistic component that potentially places their decision making process in a different category than most other industries, principal photography may, out of necessity, occur outside the United States solely or partially based on creative and artistic requirements of the project. For example, a script may call for an authentic location that only exists at a non-U.S. venue. However, research has indicated that since the beginning of the 1990s, artistic factors—as opposed to economic factors—have had little influence on film and television producers’ decision to produce a project outside of the United States. These primary economic
determinants for choosing the location of production include: (1) labor costs; (2) monetary exchange rates; and (3) tax incentives.\textsuperscript{13}

If the problem of runaway production is to be solved, then it is necessary first to determine the precise effect of each of these economic factors on producers' decision to produce within or outside of the United States, and to weigh the importance of each factor in the decision process. There have been several commentaries on the matter. For example, one law review article has concluded that it is impossible to measure the influence of each factor in the decision of a production to runaway.\textsuperscript{14} Another report, on the other hand, suggests that "[m]any people in the Canadian film and television industry believe that the single most critical factor in accounting for the presence of U.S. production in Canada is the value of the dollar," and that there is "some evidence to suggest there is an inverse relationship between the exchange rate and the level of production, although it is far from conclusive."\textsuperscript{15} Still another commentator argues that the tax incentives provided by governments are the primary factor in deciding where to locate production.\textsuperscript{16} In spite of the variety of opinions on the matter, most commentators and studies default to a position of aggregating the economic factors as "costs" of producing film and television projects, concluding that such costs are either increasing within the United States and/or decreasing at locations outside the United States, thereby collectively determining the location of production.\textsuperscript{17} My conclusion is that regardless of the influence of any single factor within the balancing of "costs" in choosing a location for production, the international tax policy of the

\textsuperscript{[S]}tates there is no evidence to support the conclusion that foreign incentives alone have been the reason that U.S.-based productions have been growing in other countries. Instead, the Department of Commerce concludes that globalization, rising costs, foreign incentives and technological change in the industry have combined to transform the U.S. industry into an increasingly dispersed global industry.

\textit{Id.}

\textsuperscript{13} DEPT' OF COMMERCE, MIGRATION OF FILMS, supra note 9, at 29; NEIL CRAIG ASSOCS., supra note 10, at 43; Ulich & Simmens, supra note 10, at 362–65; Boryskavich & Bowler, supra note 10, at 31.

\textsuperscript{14} Boryskavich & Bowler, supra note 10, at 36.

\textsuperscript{15} NEIL CRAIG ASSOCS., supra note 10, at 12.

\textsuperscript{16} McDonald, Through The Looking Glass, supra note 10, at 903.

\textsuperscript{17} DEPT' OF COMMERCE, MIGRATION OF FILMS, supra note 9, at 59–64; KATZ, 2001 PRODUCTION REPORT, supra note 10, at 6–7; THE MONITOR REPORT, supra note 10, at 4–5; KEVIN KLOWDEN ET AL., FILM FLIGHT, supra note 10, at 17–18.
United States will require eliminating foreign MPIs as a factor in taxpayers deciding whether to produce in the United States or in another country.\textsuperscript{18}

Although the precise effect of each economic factor has yet to be quantified, there is unanimous agreement among research that certain film and television projects are in fact choosing to move outside the United States for production.\textsuperscript{19} Canada, United Kingdom, Ireland, Germany, Australia, and New Zealand head the list,\textsuperscript{20} although other countries are added to and subtracted from the list of countries preferred for runaway productions each year. It should be noted that Canada has been the most consistent destination for U.S.-based producers since 1996.\textsuperscript{21}

Canada publishes an annual report providing an economic analysis of its screen-based production industry activity that details information about film and television productions from other countries.\textsuperscript{22} Canadian reports have been providing the aggregate amounts spent by foreign producers on location and service within its borders from 2002 to the present (referred to as Foreign Location and Services—"FLS").\textsuperscript{23} FLS is defined as “largely comprised of feature films and television programs filmed in Canada by foreign producers or Canadian service producers,” and is reported by Canada to have averaged $1.665 billion in U.S. currency spent in Canada per year since 2002, 80\% of which has been accounted for by U.S. producers.\textsuperscript{24} By Canada’s own accounts, U.S. producers like to film in Canada.

\textsuperscript{18} See infra Parts V. and VI.
\textsuperscript{19} DEP’T OF COMMERCED, MIGRATION OF FILMS, supra note 9, at 59–64; KATZ, 2001 PRODUCTION REPORT, supra note 10, at 6–7; THE MONITOR REPORT, supra note 10, at 4–5; KEVIN KLOWDEN ET AL., FILM FLIGHT, supra note 10, at 17–18; see also DEP’T OF COMMERCED, MIGRATION OF FILMS supra note 9, at 60 (discussing a possible solution for isolating the economic effects on runaway production) (“[a] complex regression analysis would be required to test whether cost differences were in fact driving runaway production, a task that is beyond the scope of this paper.”).
\textsuperscript{20} KATZ, 2001 PRODUCTION REPORT, supra note 10, at 17–22; Lytton, supra note 10, at 731–34; Wright, supra note 10.
\textsuperscript{21} DEP’T OF COMM., MIGRATION OF FILMS, supra note 9, at 85–87 (citing the Netherlands and South Africa as runaway destinations); Katz, 2005 Production Report, supra note 10, at 33–61 (citing Eastern Europe as a destination).
\textsuperscript{22} CANADIAN MEDIA PROD. ASS’N AND ASS’N DES PRODUCTEURS DE FILMS ET DE TÉLÉVISION DU QUÉBEC, PROFILE 2012, AN ECONOMIC REPORT ON THE SCREEN-BASED PRODUCTION INDUSTRY IN CANADA [hereinafter CMPA 2012 REPORT].
\textsuperscript{23} The individual CANADIAN MEDIA PROD. ASS’N AND ASS’N DES PRODUCTEURS DE FILMS ET DE TÉLÉVISION DU QUÉBEC, PROFILE reports covering each year from 2005 through 2012 are available at http://www.cmipa.ca/industry-information/profile.
\textsuperscript{24} CMPA 2012 REPORT, supra note 22 at 76–77 (The percentage of FLS that is comprised of U.S. producers has not been reported every year by Canada.).
Reports from other countries indicate similar activity by U.S. producers in their countries.25

B. Six Studies of the Causes and Economic Impact of Runaway Production

While not reaching uniform conclusions, six studies have provided detailed analysis regarding the causes and the economic impact of runaway production,26 and each successive study and academic review of such studies has explored possible reasons for such differences from previous reports, sometimes pointedly disagreeing. The issue of runaway production has mostly been framed as an international trade issue that affects jobs and economic revenue; that is, U.S. jobs and economic revenue are lost when productions runaway to other countries. There has been disagreement regarding the influence of each economic factor on the location of production, as well as consistent disagreement concerning the exact number of jobs and the precise amount of economic revenue that the U.S. is losing because of runaway production. The amount of economic loss has been estimated to be as low as $1.7 billion and as high as $10.3 billion per year; the number of U.S. jobs lost has been estimated to be as low as 23,500 per year and as high as 47,000 per year.27

Whether or not runaway production should be addressed by the government because of international trade requirements or the extent of claimed loss of American jobs and economic revenue is beyond the scope of this article and no conclusions will be drawn in regards to these two issues. However, it is my position that the availability of foreign MPIs for U.S. film and television production companies


27. THE MONITOR REPORT, supra note 10; KATZ, 2001 PRODUCTION REPORT, supra note 10; KATZ, 2005 PRODUCTION REPORT, supra note 10; see also McDonald, Through The Looking Glass, supra note 10, at 902-19 (evaluating the labor and economic conclusions in certain reports). but see NEIL CRAIG ASSOCS., supra note 10, at 1, 24 (claiming that employment in the U.S. film and television industry increased 6.6% between 1998 and 2004).
requires a reexamination of the effect that such foreign MPIs have on U.S. international tax policy as well as the appropriate responses thereto. Therefore, for the purposes of this article, I need only demonstrate that foreign MPIs are one of the factors in the decision of U.S.-based producers as to where to locate their productions. Whether or not there exists reliable demonstration or proof of the exact extent of lost U.S. jobs and economic revenue should not be determinative for the United States to act. In this regard, every study and commentary that has analyzed the causes of runaway production (including the study commissioned by the Canadian government) has reached the same conclusion: tax incentives are a factor in the process of determining the location of film and television production. Therefore, the foreign MPIs lack synergy with U.S. international tax policy, strongly suggesting an evaluation of those policies.  

C. U.S. Taxpayers Utilizing Foreign Motion Picture Tax Incentives

Addressing the issue of runaway production also requires determining which U.S. taxpayers are utilizing foreign MPIs. MPI users are primarily major studios, mini-major studios and the television companies associated with them. For purposes of this article, these producers are defined as taxpayers that are large U.S.-based companies investing capital and selling their goods and services both domestically and abroad, companies that are also known as MNCs. The countries providing incentives do not report the identity of the recipients which precludes a definitive finding that U.S.-based MNCs have been receiving the foreign MPIs. Although the concrete evidence is lacking, certain conclusions can be drawn from the statistics that have been reported. Since 2003, 73% to 89% of all FLS in Canada has occurred in British Columbia and Ontario. In addition, the British Columbia Film Commission and the Ontario Media Development Corporation ("OMDC") provide an annual list of productions that have filmed in each province during the year, and includes such information as the title and company of each production. Further, in 2012, British Columbia reported FLS production activity of forty-seven feature films (not including digital

28. See Graetz, supra note 5, at 327 (stating that "[t]he important role played by tax considerations in business activities is not surprising, and is confirmed by more sophisticated empirical analyses," in his analysis of the U.S. taxation of large inbound and outbound flows of both direct and portfolio investment).
29. See infra notes 31–36 and accompanying text.
30. See OPTIONS FOR TAXING, supra note 5, at 3.
31. CMPA 2012 REPORT, supra note 22, at 80.
feature films), twenty-six television series, eleven television pilots and
double movie-of-the-week productions for an aggregate amount spent
in British Columbia of approximately $813 million. U.S.-based
major studios and their television companies were reported to be
approximately 85% of those projects, accounting for seventy-five of
the eighty-eight productions. In addition, production activity
provided by OMDC revealed thirty-one FLS feature films, television
series, television pilots, and movie-of-the-week productions for an
aggregate amount spent in Ontario of approximately $380 million.
U.S.-based major studios and their television companies represented
approximately 87% of the projects, that is, accounting for twenty-
seven of the thirty-one foreign productions. Overall, the British
Columbia Film Commission and the OMDC information provided for
productions filmed in each province between 2000 and 2011 clearly
support the conclusion that U.S-based MNCs (that is, major studios,
mini-major studios and the latter corporations' television companies)
have represented significant FLS production activity in these
provinces during those twelve years. Thus, it is reasonable to
assume that MNCs are making their economic decisions with the goal


33. 2012 Production Credits, CREATIVE BC, http://www.creativebc.com/industry-sectors/motion-picture/production-credits (last visited Mar. 10, 2014) (Walt Disney, Co. accounted for eleven projects; Sony Corp. accounted for seven projects; CBS Corp. accounted for four projects; Time Warner, Inc. accounted for eighteen projects; Viacom, Inc. accounted for three projects; Comcast Corp. accounted for twelve projects; News Corp. accounted for seventeen projects; and thirteen projects by the following publicly traded companies: World Wrestling Ent., Inc., Mattel, Inc., DirectTv, Lionsgate Ent., Summit Ent., Discovery Commc’ns, Inc., Mandalay, and Crown Media Holdings, Inc.).


35. Id. (The Walt Disney Co. accounted for four projects; Sony Corp. accounted for two projects; CBS Corp. accounted for three projects; Time Warner, Inc. accounted for two projects; Viacom, Inc. accounted for nine projects; Comcast Corp. accounted for ten projects; three projects by the following publicly traded companies: Lionsgate Ent. and Crown Media Holdings, Inc.; and one project by The Weinstein Co.).

36. British Columbia Production Credits supra note 32; PRODUCTION IN ONTARIO 2012, supra note 34; Made in the UK, BRITISH FILM INSTITUTE, http://industry.bfi.org.uk/ukfeaturefilms (last visited Mar. 10, 2014) (The British Film Commission does not provide detailed statistics regarding films that choose the UK for production, but the British Film Institute ("BFI") does provide information on some of the films and television projects that have filmed there between 2005 and 2009, reporting that fifty-five feature films filmed in the U.K. during that time period were by U.S.-based MNCs.).
of maximizing profits for their shareholders, and are exploiting all possibilities of increasing their profits including accessing the available foreign MPIs for their projects.

D. Runaway Production Is a Tax Issue

An important issue to examine is why runaway film and television production is a tax issue and not simply an international trade issue and/or labor issue. To be clear, runaway production definitely entails international trade and labor issues, which have been pursued by the U.S. government, commentators and private citizens. However, my position is that the use by foreign governments of their tax laws to alter the behavior of taxpayers not based in their country (in this case, to attract capital investments, loans and expenditures to their countries, i.e., runaway production) affects the U.S. tax code (specifically, U.S. international tax laws), and therefore, indicates the need for an active response by the U.S. government, which should entail a review of, and possible amendment of, its international tax laws to account for the monies received by U.S.-based MNCs from foreign MPIs. The primary way foreign governments have attracted foreign investment to their countries via runaway production is through their tax laws and enforcement of those tax laws by their collection agencies. The process supports a conclusion that runaway production is a tax issue. Of course, there are many different types of tax incentives offered by nations around the world, each providing unique benefits and having different requirements. A company seeking to access tax incentives such as those offered in Canada, Ireland, the United Kingdom, France, and Australia are required to file an income tax return in the appropriate country in order to be eligible to receive the benefit of that country’s film and television tax

37. See infra Part IV.

38. Whether this position will remain valid when a foreign government pays a direct subsidy to a U.S. producer to runaway rather than using their tax code to affect the incentive will take further research to determine.

incentive in accordance with those countries' tax laws. For example, to claim the Federal Canadian Film or Video Production Tax Credit a qualified corporation must file a corporation income tax return with the Canada Revenue Agency with proper supporting documentation. Similar revenue agencies in Ireland, the United Kingdom, France, and Australia process the film and tax incentives in those and other countries which provide tax incentives.

Once again, the fact that foreign tax incentives operate through foreign tax codes and enforcement agencies indicates that the process is a tax issue subject to tax analysis. In a certain sense, the fact that these tax issues fall within "runaway" film and television production is not determinative, that is, an analysis of their effect on U.S. international tax policy would be indicated if the foreign tax incentives were provided to other U.S.-based MNCs, for example, MNCs in the computer and electronic industry or the apparel industry.

E. Tax Expenditure Versus Tax Revenue

Professor Stanley Surrey defines “tax expenditures” as a government's use of its tax code for purposes other than reaching an appropriate normative baseline of net income. There have been many articles written that focus on the difficulty of determining what tax items are properly accounted for within the normative baseline of income tax (revenue) and which tax items are properly categorized as “revenue losses attributable to [tax] laws which allow a special exclusion, exemption or deduction from gross income or which

40. How to Claim Your Canadian Film or Video Production Tax Credit, CAN. REVENUE AGENCY, http://www.cra-arc.gc.ca/tx/nnrsdnts/film/ftc-cip/clm-eng.html (last visited Mar. 10, 2014) (Among the supporting documents required to be filed with the taxpayer's Form T2 Corp. Income Tax Return is Form T1131, a Canada Revenue Agency form required to be completed to claim the Canadian film or video production tax credit.).


42. STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX REFORM (2d ed. 1973); JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017, JCS-1-13 (Joint Comm. Print 2013) [hereinafter ESTIMATES OF FEDERAL TAX EXPENDITURES 2013] (The Congressional Budget Office and the U.S. Treasury have published a list of tax expenditures every year since 1974.); Edward D. Kleinbard, Chief of Staff, Joint Comm. on Taxation, Address to the Chicago-Kent College of Law Federal Tax Institute 7 (May 1, 2008) [hereinafter Kleinbard, Address].
provide a special credit, a preferential rate of tax or a deferral of tax liability.\textsuperscript{43}

Professor Edward Kleinbard succinctly frames the problem when he states:

Tax expenditure analysis has always been controversial, and there is today a voluminous literature criticizing its premises and implementation as a tool of tax policy... critics argue that the ideal 'normal' tax system from which tax expenditures are identified does not correspond to any generally accepted formal definition of net income.\textsuperscript{44}

For purposes of this article, evaluating the U.S. international tax policy implications of foreign MPIs does not require entering into debates about tax expenditure theory. The fact that incentives for film and television production are provided via those other countries' tax codes render those foreign incentives subject to U.S. international tax policy analysis whether or not those tax incentives fulfill any definition of tax expenditures. Regardless, there is a strong argument that film and television production incentives provided through foreign (and the domestic, i.e., U.S.) tax codes are added as special tax preferences and not to determine what is properly net income for income tax purposes,\textsuperscript{45} which has implications regarding the remedies

\textsuperscript{43} \textit{ESTIMATES OF FEDERAL TAX EXPENDITURES 2013}, supra note 42.

\textsuperscript{44} Kleinbard, Address supra note 42, at 7.

\textsuperscript{45} See generally E&B Data, \textit{Effects of Foreign Location Shooting on the Canadian Film and Television Industry}, \textit{CANADIAN HERITAGE} 2, 73 (Mar. 2010), http://en.ebdata.com/wp-content/uploads/2012/04/PC-Shooting-A.pdf (stating "[f]oreign location shooting activities are deemed desirable by federal and provincial governments, which treat these activities beneficially by offering tax credits to production companies."). The report concludes with the observation that:

Foreign location shooting activity...[exceeding] $1 billion in Canada for more than ten years...also ties in with the notion of foreign direct investment, not so much by the aspect of foreign ownership but by the aspect of foreign capital injection. This injection of capital takes the form of local spending and is characterized by jobs [labour for actual shoots, but also supplier activities,] value added [contribution to GDP,] and a contribution to public finances. For that reason, attracting foreign location shooting is desirable in the view of public authorities [federal, provincial and local] in Canada as elsewhere... . To the extent that the net fiscal benefits exceed tax expenditures [in the form of tax credits] and that the benefits do not kick in until local spending has actually occurred, the benefit for governments seems self-evident.

\textit{Id.; OXFORD ECONOMICS}, supra note 25, at 50–52 (2012). In part:
[T]he current Film Tax Relief came into force on 1 January 2007 and is based on an enhanced deduction from taxable income for film production companies that can be converted into a payable tax credit. Film Tax Relief was extended at the end of 2011 to 2015 following the extension of the European Commission's ("EC") State Aid approval of the Government's application to extend the duration of the scheme. As noted by Film Minister Ed Vaizey, at the time of the announcement, "Film Tax Relief is at the heart of our drive to support the production of culturally British Films within a sustainable and vibrant industry." In reviewing the Film Tax Relief, the Treasury considered carefully the rationale for particular support for the film industry. Film Tax Relief plays a key role in attracting large, internationally mobile productions from the USA to the UK and Europe. Competition to attract film producers to shoot films in North America and non-European destinations is fierce. A key element is the availability of tax relief. The use of the tax system to support film production is widespread, including in individual US states and countries that benefit from lower labour and other costs, such as South Africa and New Zealand. Given that the film industry is highly internationally mobile and dominated by the U.S. major studios, the Film Tax Relief is important in leveling the terms on which the UK can compete with other global locations in attracting both inward investment productions and subsequent postproduction work.

*Id; see also* CMPA 2012 REPORT, *supra* note 22, at 76–77, stating:

Canada's ability to mitigate the effects of the rising dollar is a testament to the quality of its crews and infrastructure and the ability of provincial governments to respond quickly with enhanced incentives for foreign producers. The enhanced incentives introduced by many Canadian provinces over the last five years have also helped to maintain Canada's competitiveness in the increasingly globalizing location-production market.

*Id.* The report further notes that:

In a bid to restore its level of FLS production to the volumes reached in the early 2000s, Ontario expanded its tax credit in June 2009 beyond qualifying labour expenditures to also include non-labour expenditures [an all-spend tax credit]. This initiative appears to have helped the province buck the trend towards lower FLS production levels in Canada.

*Id. See also* Boryskavich & Bowler, *supra* note 10, at 34; NEIL CRAIG ASSOC., *supra* note 10, at 6 ("The federal and provincial governments provide financial subsidies, tax incentives...and other policy tools...to help level the playing field for Canadian producers and distributors in face of tremendous competitive advantage enjoyed by film and television producers in the U.S. and elsewhere."). Regarding U.S. film and tax incentives, see J. Clifton Fleming, Jr. & Robert J. Peroni, *Can Tax Expenditure Analysis Be Divorced from a Normative Tax Base?: A Critique of the "New Paradigm" and its Denouement*, 30 VA. TAX REV. 135 (2010) (describing the U.S. manufacturing incentive in Internal Revenue Code section 199). "This provision was enacted in 2004, not for the purpose of more accurately defining income, but expressly to 'make investments in domestic manufacturing facilities more attractive' and to 'assist in the creation and preservation of U.S. manufacturing jobs.'" *Id.* (citing JOINT COMM. ON TAXATION,
that have been pursued by the U.S. federal and state governments so far, as well as possible future solutions. To be clear, whether or not the U.S. and foreign MPIs satisfy a definition of "tax expenditures" does not alter the inquiry or conclusions of this article, but is only included to illustrate that a government's use of its tax code for reasons other than to raise revenue is well-documented and critiqued.

III. Carrots, Sticks, and Sermons

A. Overview of Public Policy Tools

Runaway film and television production has been identified as a public policy issue in the United States, evinced by the fact that the U.S. government and many state governments have enacted laws—primarily tax laws—to address this issue. Professor Evert Vedung has written that when a government is faced with a public policy issue, it has various tools it can use. He has identified three categories within which government public policy tools can be placed. The first set of tools is economic, the second is regulatory, and the third is informational, or more popularly labeled "the carrot, the stick, and the sermon." When attempting to change the behavior of a nation "the government may either force us, pay us or
have us pay, or persuade us." Professor Vedung’s analysis refines the common definitions and categories by adding subcategories to carrots and sticks, providing examples to illustrate further differences between each category. The goal of Part III is to outline a basic framework for possible policy actions suggested by Professor Vedung in order to be able to identify and categorize the actions the federal and state governments have taken thus far to address the problem of runaway production, then to use the paradigm, where applicable, in order to propose solutions to the runaway problem within U.S. international tax policy provided in Part VI.

B. Carrots

Obviously, a carrot is a reward to a party who engages in behavior that is desired by a government. Those who receive carrots are placed in a better position than if they had not received them, thereby reducing the cost of engaging in the behavior desired by the government. A government’s goal is achieved when the future decisions of the affected parties reflects government’s policy goals, but implementation comes at a cost because it generally reduces government tax receipts. Consequently, as Professor Vedung explains, economic provisions, also called carrots, can be either

54. Id. at 30. The use of carrots and/or sticks has been examined in the academic literature in other areas of the law. See generally Brian D. Galle, Carrots, Sticks, and Salience 290 (Boston College Law School Faculty Papers, 2013) [hereinafter Galle, Salience]; Brian Galle, The Tragedy of the Carrots: Economics and Politics in the Choice of Price Instruments, 64 STAN. L. REV. 797 (2012) [hereinafter Galle, The Tragedy of the Carrots] (wherein he provides a background on the use of the terms carrots and sticks in policy literature); Bruce Zagaris, The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?, 35 GEO. WASH. INT’L L. REV. 331 (2003); Howard F. Chang, Carrots, Sticks, and International Externalities, 17 INT’L REV. L. & ECON. 309 (1997). In the academic law literature examining areas of law other than runaway production or tax, the definition of carrots basically mirrors Professor Vedung’s definition of “positive carrots” in addition to reaching certain other parallel conclusions with Professor Vedung. However, the definition of sticks in academic law literature does not precisely or uniformly match Professor Vedung’s definition and only one of the academic law literature articles addresses sermons, electing to categorize it under sticks.


56. Id. at 32. For a similar definition of carrots see Galle, Salience, supra note 54, at 6, 7; Galle, The Tragedy of the Carrots, supra note 54, at 801 (examining externality remedies); Lior Jacob Strahilevitz, Reputation Nation: Law In an Era of Ubiquitous Personal Information, 102 NW. U. L. REV. 1667, 1711–12 (2008) (examining carrots and sticks in the context of government’s control of information); see generally Zagaris, supra note 53, at 332.

57. Vedung, Policy Instruments, supra note 51, at 32; see Galle, Salience, supra note 54, at 6, 7; Galle, The Tragedy of the Carrots, supra note 54, at 801.
positive or negative. Positive carrots (economic incentives) are provided by a government to improve the economic situation of the recipient, thereby reducing the costs of the activity, and negative carrots (economic disincentives) are financial disincentives designed to place the target actor in a less advantageous economic situation, thereby increasing the costs involved with the targeted activity. Examples of economic incentives include cash transfers, cash grants, subsidies and tax expenditures (exemptions, write-offs, credits); examples of disincentives are taxes, charges, fees, custom duties, and tariffs. The government’s goal of changing the behavior of the affected parties remains constant whether positive or negative economic incentives are used, the difference is in the cost to the government.

As noted, incentives have a price which must be paid by the government whether or not the government reaches the goal of changing the target party’s actions. As such, a criticism of positive carrots is that they can be cost inefficient because they provide an incentive for a party to act in a manner that the party would act even without the economic subsidization. It is also important to note that if a government decides to discontinue a positive carrot, then the government’s action is neither properly characterized as a negative carrot, nor is it properly identified as a stick within Professor Vedung’s definitions. Rather, the government is deciding to no longer subsidize that activity or those parties who no longer receive

58. Vedung, Policy Instruments, supra note 51, at 43 (Carrots generally reduce government tax receipts and the reduction or elimination of a carrot can increase tax revenues.); see Galle, The Tragedy of the Carrots, supra note 54, at 811; see also Giuseppe Dari-Mattiacci & Gerrit De Geest, Carrots, Sticks, and the Multiplication Effect, 26 J.L. ECON. & ORG. 365 (2010) for an empirical analysis of the issue.

59. Id. at 43.

60. Id. at 43; but see Galle, Salience, supra note 54, at 6, 7 (defining negative carrots as sticks).


62. Leeuw, supra note 61 at 78-79.

63. Id. at 79; see also Frans C.J. van der Doelen, The "Give and Take" Packaging of Policy Instruments: Optimizing Legitimacy and Effectiveness, in CARROTS, STICKS, AND SERMONS: POLICY INSTRUMENTS AND THEIR EVALUATION 138 (Marie-Louise Bemelmans-Videc et al. eds. 2007) (citing BRUNO S. FREY, DEMOCRATIC ECONOMIC POLICY: A THEORETICAL INTRODUCTION (1983)) [hereinafter Frans C.J. van der Doelen].
the positive carrot. This is a subtle but important point, since once a party receives an incentive it then often becomes a baseline of expectations for that party. This makes removal difficult even if such policy instruments are not achieving the goals that motivated its implementation—that is, not addressing the issue they were intended to address. A government may discontinue a positive carrot for various reasons, but the public policy goal is to discontinue the subsidy when the identified public policy issue is solved through the use of such instrument. Of course, if a policy problem persists after a positive carrot has been in place for a reasonable amount of time, then it should indicate that a reevaluation of the public policy instruments is warranted, especially where there is reduced tax revenue.

Professor Vedung further differentiates carrots from sticks when he points out that both positive and negative carrots provide actors the ability to choose whether or not to engage in the activity subject to the carrots. In contrast, sticks (discussed below) require conformity and often subject a violator to a penalty or fine for failure to conform to the stick. Unlike sticks, positive and negative carrots simply adjust the costs of engaging in an activity; they neither prescribe nor prohibit the affected actions. For example, Internal Revenue Code ("I.R.C.") section 181 allowed a taxpayer to deduct up to $15 million in qualifying film and television production costs in the years the costs are incurred instead of capitalizing the costs and deducting them over a number of future years. Providing a taxpayer a current year deduction rather than requiring smaller deductions over many future years is a positive carrot because of the time value of money. I.R.C. section 181 decreases present value of the cost of spending funds on film and television costs for the taxpayer choosing to spend funds on such costs (assuming the other requirements of I.R.C. section 181 are satisfied). Under I.R.C. section 181, a taxpayer neither is required to spend funds on qualifying film and television costs nor is prohibited from expending funds on such costs. In fact, a taxpayer that expends funds on such qualifying costs is not even required to elect to currently deduct the costs but may choose to continue capitalizing and deducting the costs over many future years.

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64. Vedung, Policy Instruments, supra note 51, at 31–32.
65. Id. at 32.
66. I.R.C. § 181 (2013). I.R.C. § 181 ended as of December 31, 2013, and as of the time of the writing of this article it is not known if it will be extended.
years. The costs of the activity, here spending funds on film and television production, have been altered by the tax code provision, but taxpayers can exercise choices to engage or not engage in such affected activities. Even if engaged in such activities, they can choose to utilize the current deduction or not. Of course, those taxpayers choosing to utilize the current deduction are reducing the amount of tax revenue available to the federal government subsidizing such activity.

C. Sticks

Professor Vedung defines regulatory instruments ("sticks") as a government's use of "rules and directives which mandate receivers to act in accordance with what is ordered in these rules and directives." Although Professor Vedung is focusing on the actions of governments seeking to address public policy problems, it is important to note that regulations have been widely accepted as necessary in market economies that "require basic infrastructure to function efficiently."

"[Market economies] need basic rules of the game which include, for example, trade, incorporation, competition, intellectual property, weights and measures, money supply and financial institutions."

Professor Vedung differentiates his basic definition of sticks from the more common definitions that contain a requirement for negative consequences or threat of negative consequences if certain rules are not followed. He points out that not all regulations are backed by

67. I.R.C. § 181(a)(1), (c)(1).
68. Id.
70. Vedung, Policy Instruments, supra note 51, at 31.
72. Id. at 64 (noting that government regulatory action is historically controversial because it is often identified as ineffective, excessively costly and difficult to enforce because they "address situations reasonably well managed by the forces of the marketplace and liability law.").
73. Vedung, Policy Instruments, supra note 51, at 31; see Galle, Salience, supra note 54, at 2 (defining stick in the context of externalities as a policy choice to "raise the price of the externality-producing good."); Galle, The Tragedy of the Carrots, supra note 54, at 800 (defining "stick" as a policy that "can make the externality producer worse off than under the status quo."); Strahilevitz, supra note 56, at 1711 ("the 'stick' approach punishes undesirable behavior (via criminal fines, civil liability, or the condemnatory use of the bully pulpit.").
“fines, imprisonment or other types of punishment” which are but one categorical means of enforcement.\textsuperscript{74} Professor Vedung’s definition of sticks differs from the common understanding of the metaphor in that it encompasses a greater variety of rules and directives.\textsuperscript{75} More specifically, if parties are obligated to obey a rule, it is a stick accompanied with a means of enforcement together with some form of punishment.\textsuperscript{76} Considering the other side of the coin, what would not be considered a regulation in the context of public policy instruments? Professor Vedung answers this question by stating that:

[P]ractically everything that governments undertake would then be ‘regulation.’ However, that is not the way the term is used in the present context where regulation is regarded as just one of the wider variety of tools that governments have at their disposal to exert power over the actions of their citizens.\textsuperscript{77}

His point is that regulations must be defined and evaluated vis-à-vis the other available public policy tools which, once properly defined and categorized, assists in finding the proper, effective balance of those tools to solve a problem.\textsuperscript{78}

Professor Vedung further differentiates sticks from carrots and sermons by the degree of control involved within the regulations.\textsuperscript{79} Laws that state what must be done by parties are positive sticks and laws that mandate what parties cannot do are negative sticks.\textsuperscript{80} He primarily focuses on regulations that prohibit actions (negative sticks) which can range from “unconditional [absolute]” on one end of the spectrum where the goal is complete elimination of the targeted activity, to “obligation[s] to notify” on the opposite end of the negative carrot spectrum where the goal is to allow an activity once the proper authorities are simply notified of a party’s intention to engage in the activity.\textsuperscript{81}

\textsuperscript{74.} Vedung, \textit{Policy Instruments, supra} note 51, at 31.
\textsuperscript{75.} \textit{Id.} at 31–32.
\textsuperscript{76.} \textit{Id.} at 31.
\textsuperscript{77.} \textit{Id.} at 32.
\textsuperscript{78.} \textit{Id.} at 50–51.
\textsuperscript{79.} \textit{Id.} at 41–42.
\textsuperscript{80.} Vedung, \textit{Policy Instruments, supra} note 51, at 41.
\textsuperscript{81.} \textit{Id.} at 42.
A further important distinction that Professor Vedung makes is the removal of taxes from the stick category, which is seemingly counter-intuitive. If an action results in a tax that is an equivalent amount of a fine for the same exact action, then it is arguable that there is no difference between the tax and the fine since engaging in the activity places the party in the same financial position—this of course excludes the negative moral stigma which would accompany being fined. "We may justifiably ask where the authoritative element of a tax program ends and the economic element begins." Professor Vedung bases his conclusion that a tax is a negative carrot and not a stick on the ability of the actor to choose to engage in activity that results in a tax and the inability to choose to engage in that same activity if it is subject to a fine because it is prohibited. He further supports his conclusion by pointing out that engaging in the activity that results in a penalty or fine classifies the actor as an outlaw rather than as an entrepreneur subject to a tax, which would be a cost of doing business. This article takes the position that the public policy issue of runaway production is a tax issue which removes sticks from the proposed reforms herein.

D. Sermons

"Sermons" is a metaphor commonly applied to the dissemination of information regarding targeted activities and includes "measures undertaken to influence addressees through the transfer of knowledge, communication of reasoned argument, persuasion, advice, moral appeals, and so on." The issues and stated negative effects of runaway production have not only been disseminated by the U.S. government, state governments, private parties, and by academicians, but they have also been extensively reported in popular news outlets such as The New York Times, The Wall Street Journal, The Los Angeles Times, and The Hollywood Reporter. Although it

82. Id. at 32.
83. Id.
84. Id. at 32, 35–36.
85. Id. at 35.
86. But see infra Part IV.A.4.
87. Vedung, Policy Instruments, supra note 51, at 48.
is important to recognize information as a means within the policy instruments of a government, sermons decrying runaway production give rise to a conundrum. Producers are engaging in behavior that is fundamental to U.S. economic philosophy, namely, that a producer should pursue that course of action that minimizes costs and maximizes revenue within the parameters of what is lawful.\textsuperscript{89} Further, the broad U.S. policy in support of globalization has been cited as one of the factors that has increased the rise of producers' choice of foreign location for production.\textsuperscript{90} In the context of MNCs, they have a duty to their shareholders to pursue such courses of action. The latter is strengthened by the conclusion that MNCs are acting within the laws of both the United States and foreign countries when they engage in runaway production and when they use foreign MPIs.\textsuperscript{91} Further, the parties engaging in runaway production, primarily U.S.-based MNCs, are a relatively small number of motivated, well-informed citizens who cannot be classified as ignorant of the relevant issues. Sermons, therefore, do not provide governments with the leverage required to affect the behavior of the producers engaging in runaway production and are not a viable basis for addressing that particular issue.

\textsuperscript{89} See infra Part IV.A.4, regarding the claims of certain parties that the MPIs provided by foreign countries violate international trade laws.

\textsuperscript{90} DEPT OF COMMERCE, MIGRATION OF FILMS, \textit{supra} note 9, at 59 (Globalization is "the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people [labor] and knowledge [technology] across international borders") (citing IMF Staff, \textit{Globalization: Threat or Opportunity?}, INTERNATIONAL MONETARY FUND (Apr. 12, 2000), available at http://www.imf.org/external/np/ext/ib/2000/041200to.htm). \textit{See also \textit{THE MONITOR REPORT}, \textit{supra} note 10, at 4; \textit{see also} Avi-Yonah, \textit{supra} note 5, at 1575–76 (discussing globalization in the context of worldwide tax competition).

\textsuperscript{91} See infra Part IV.A.4, regarding the claims of certain parties that the MPIs provided by foreign countries violate international trade laws.
IV. U.S. Responses to Foreign Film and Television Tax Incentives Since 1997

Author and policy advisor Frans C.J. van der Doelen shrewdly advised that:

In the abstract, the situation should not be that difficult. The policymaker faces the emergence of a policy problem that requires a policy response.... Should the response involve subsidies, loans, regulations, direct service, penalties, information, the use of force, or tax credits, to name but eight.... The policymaker picks one, or a cluster of several, to appropriately respond to the problem.... Implementation takes place according to the blueprint for the selected instrument. The problem is contained, maybe even solved, and the policymaker moves on.... In reality, it seldom if ever happens this way.\(^9^2\)

A. U.S. Federal Government

1. The Monitor Report

Although Canada began offering tax advantages to producers beginning in the 1980s, it was their enactment of the Film or Video Production Services Tax Credit ("PSTC") in late 1997 that marked the beginning of the current debate concerning runaway production.\(^9^3\) Recognizing the impact of this 1997 Canadian legislation, at the beginning of 1999 entertainment labor groups, specifically, the Screen Actors Guild ("SAG") and the Directors Guild of America ("DGA"), commissioned Monitor Company to investigate and provide a report about the causes and impact of runaway film and television production ("Monitor Report").\(^9^4\) By August 1999, the U.S. House Ways and Means Committee was discussing making the issue a priority to be addressed at the World Trade Organization Ministerial Conference later that November.\(^9^5\) Putting aside the fact

\(^9^2\) Frans C.J. van der Doelen, supra note 63, at 131.
\(^9^3\) NEIL CRAIG ASSOCS., supra note 10, at 10.
\(^9^4\) THE MONITOR REPORT, supra note 10, at 2.
\(^9^5\) Objectives for the WTO Seattle Ministerial Meeting 1999, supra note 10, at 7-11.

The Hon. Jerry Weller, a Representative in Congress from the State of Illinois stated:

I want to reintroduce to the Subcommittee an issue that I brought before the full Committee during the markup of the Financial Freedom Act of
that the Monitor Report was commissioned by private labor groups and could be considered biased, members of Congress nevertheless referenced the analysis and the conclusions of the Monitor Report in concluding that the proper response was for the U.S. government to “level the playing field.” The authors of the Monitor Report concluded that there was a 25% cost production disadvantage by filming in the United States rather than Canada, and that “[w]ithout a meaningful response (or some unforeseen development abroad), production employment opportunities and associated economic benefits will continue to leave the United States at a significant rate.” The Monitor Report did not propose a solution to the issue but rather stated:

The solutions will not be simple because the causes are several and very complex. However, the cost gap to be closed to retain production in the U.S. may not be the entire 25% production cost disadvantage... if the budgets for U.S. productions were brought to within 10% to 15% of costs in Canada, then they [producers] would make the argument to keep that production in the U.S.

The authors were seemingly inferring that the United States would be wise to address the relative costs through its own tax incentives, thereby reducing the costs of filming in the United States. However, since the issue was framed in the context of international trade at the time, discussions by members of Congress regarding the proposed

1999. The issue is the loss of 20,000 American film industry jobs from runaway film production. I want to raise this issue to urge that our domestic film industry be given a seat at the table at the WTO talks in Seattle to address the cultural content issue and its relationship to runaway film production.

Id. Weller further stated that he introduced legislation during the committee discussion on the Financial Freedom Act of 1999 providing a wage based tax credit and creative financing tax incentives to counter the loss of film production jobs to Canada. Id. The Ministerial Conference is a meeting where high-level international trade decisions are made by representatives of each country that is a member of the World Trade Organization. Id.

96. Objectives for the WTO Seattle Ministerial Meeting 1999, supra note 10, at 7–8, 10, 22 (The Hon. Jerry Weller, a Representative in Congress from the State of Illinois stated, “The United States shouldn't be put in a competitive disadvantage by tax incentives offered abroad. Rather we need to level the playing field for the small businesses impacted by the runaway production and create jobs in America, for Americans.”).

97. THE MONITOR REPORT, supra note 10, at 5.

98. Id.
agenda for the 1999 World Trade Organization Ministerial meeting centered on whether or not Canada's tax incentives were illegal under existing trade laws. The issue was reviewed at this time in terms of sticks, namely, whether foreign tax incentives violated the rules of bilateral and multilateral trade agreements and the United States' remedies to such claimed rules violations.

2. The U.S. Department of Commerce Report Triggers Positive Carrots

The U.S. government subsequently commissioned its own study which the Department of Commerce provided in a report issued in 2001 ("Commerce Report"). The Commerce Report concluded by noting that "a wide variety of private and public sector actions ha[ve] been suggested" but urged further study of the proposals even though "industry observers have proposed that the United States or individual states offer comparable tax incentives to encourage production in the United States." Despite the potential trade issue rule violations, the first public policy instrument on the U.S. government's agenda was positive carrots provided through enactment of federal tax laws. Four months after the release of the Commerce Report in 2001, legislation was introduced (and reintroduced in 2003) in both the House of Representatives and the Senate to amend the I.R.C. This legislation proposed a tax credit of 25% for the first $25,000 of "qualified wages" paid or incurred by an
employer with respect to each "qualified employee" in any "qualified U.S. independent film and television production" each tax year. The proposed legislation was referred to the appropriate subcommittees of the House Ways and Means and the Senate Finance Committees, but was never enacted. It is unknown why the first attempts to pass federal legislation failed, but it has been opined that it was based on a dispute regarding the extent of runaway production as a public policy problem and the perception that the proposed positive carrots would be "corporate welfare" for studios.


New federal legislation affecting the runaway film problem was drafted and enacted in 2004 through I.R.C. amendments. The legislation provided the newly created positive carrots found in I.R.C. sections 181 and 199. I.R.C. section 181 accelerates cost recovery by allowing a taxpayer to deduct qualifying film and television production costs in the years the costs are incurred instead of capitalizing the costs and deducting them over a number of future years. I.R.C. section 181 was specifically enacted to address runaway film production and federal legislators believed it would "encourage producers to bring feature film and television production projects to cities and towns across the United States, thereby


To rectify the problems of runaway productions, legislation at the local, state and federal levels is paramount . . . . Amid encouraging signs that a tax bill of significant consequence is likely to pass Congress in the coming months, it is imperative that the creative community take a proactive position to ensure that the tax bill provides incentives for domestic film production.

Id. at 369.

104. H.R. 3131; H.R. 715; S. 1278; S. 1613.


decreasing the runaway production problem." The U.S. Senate Committee on Finance cited the Department of Commerce Report in concluding that it made a "compelling case that runaway film and television production has eroded important segments of a vital American industry." On the other hand, I.R.C. section 199, which allows a taxpayer a deduction equal to a portion of the taxpayer's qualified production activities income, was not passed specifically to address runaway film production. Rather, it was implemented to mitigate possible effects of the mandatory repeal of certain U.S. tax laws that were ruled to be export subsidies prohibited by the World Trade Organization ("WTO"). The new I.R.C. section 199 was enacted to "reduce the tax burden on domestic manufacturers, including small businesses engaged in manufacturing," which includes many other manufacturers in addition to film and television producers. 

Although I.R.C. section 199 is a positive carrot that film and television producers can utilize, it cannot be properly characterized as the federal government's attempt to specifically address runaway film production since the stated objective of passing I.R.C. section 199 was to assist the economic recovery from the "recent economic downturn" in light of the mandatory repeal of the U.S. tax export subsidies. Therefore, it is arguable that once those goals are met, the underlying reasons for enacting I.R.C. section 199 shall be eliminated thereby supporting a repeal of the tax incentive regardless of the repeal's impact on the runaway production problem.

Regardless of the intentions behind the passage of these two tax code sections, they are positive carrots with the purpose of making U.S. "manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad." In addition, both laws are available to film and television producers.

But how much revenue has been forfeited by the U.S. government in order to achieve the stated goals? This is not an easy question to

110. Id. at 73-74.
111. Id. at 7, 8, 11.
112. Id. at 11.
113. Id.
115. Id.
answer. The cost of I.R.C. section 181 is clear, but the cost of I.R.C. section 199 as specifically attributed to film and television production is not. The Joint Committee on Taxation prepares an annual report estimating federal tax expenditures.\textsuperscript{116} The reports released between 2005 and 2011 estimated that the federal government provided less than $100 million in lost revenue each year attributable to corporate taxpayers' utilization of I.R.C. section 181.\textsuperscript{117} The same report estimated that between 2005 and 2011, the U.S. government incurred an average annual amount of $3.96 billion in lost revenue from I.R.C. section 199. However, this is the total amount from all qualified manufacturers; the percentage of the annual amount attributable to qualified films produced by eligible U.S. taxpayers is unknown.\textsuperscript{118} As a point of reference, the Canadian federal government has expended approximately $300 million per year for film and television positive carrots between 2005 and 2011, while the U.S. federal government has provided an average annual amount in excess of $27.9 billion for the top ten categories of corporate tax expenditures between 2005 and 2009.\textsuperscript{119} The U.S. government has provided positive carrots to

\textsuperscript{116} ESTIMATES OF FEDERAL TAX EXPENDITURES 2013, supra note 42, at 2:

Tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers . . . . Estimates of tax expenditures are prepared for use in budget analysis. They are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in determining the relative merits of achieving specific public goals through tax benefits or direct outlays.

\textit{Id.}


\textsuperscript{118} \textit{Id.}

\textsuperscript{119} CAN. DEP’T OF FIN., TAX EXPENDITURES AND EVALUATIONS 24 (2012); CAN. DEP’T OF FIN., TAX EXPENDITURES AND EVALUATIONS 23–25 (2009) (containing "Estimates" and "Projections" of "Corporate Income Tax Expenditures" for tax years 2005 through 2009); JOINT COMM. ON TAXATION, BACKGROUND INFORMATION ON TAX
address runaway production while the Canadian government has annually averaged approximately $200 million more than the U.S. government. Further, the U.S. government in that timeframe has annually allocated approximately $23.9 billion to the top ten categories of tax expenditures other than those provided under I.R.C. sections 181 and 199. Based on the aggregate and relative amounts of positive carrots provided by the U.S. government, it is hard to escape the conclusion that it has not provided positive carrots in amounts that evince it has prioritized these public policy instruments as a solution to the runaway production problem.

4. Petition Filed with the U.S. Trade Representative Under Section 301(a) of the Trade Act of 1974—A Stick

The House Subcommittee on Trade of the House Committee on Ways and Means initial inquiry over whether “what the Canadians are doing is illegal under existing trade law” was subsequently pursued by academics and private citizens. In 2001, the Film and Television Action Committee (“FTAC”) filed a petition under section 701 of the 1930 Tariff Act with the Department of Commerce requesting that the Department “initiate an investigation into whether countervailing duties should be imposed on the imports of subsidized feature films into the U[nited] S[tates].” The obvious reference was to Canada’s film subsidies. The FTAC withdrew its petition when the Motion Picture Association of America (“MPAA”) filed a motion in opposition. On September 4, 2007, the FTAC filed a petition under section 301(a) of the Trade Act of 1974 with the Office of the United States Trade Representative (“USTR”) requesting that the USTR initiate a WTO action. The FTAC made this request based on a claim that Canada’s economic subsidies to film and television production violated Canada’s obligations under

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120. See notes 116–19 and accompanying text.

121. The total amount of $23.9 billion is less the total amounts provided under I.R.C. §§ 181 and 199.

122. Objectives for the WTO Seattle Ministerial Meeting 1999, supra note 10, at 21 (Representative Richard Neal asked Representative Jerry Weller, “Mr. Weller, is it your belief that what the Canadians are doing is legal under existing trade law?”); Wright, supra note 10; Lee, supra note 10; Turco, supra note 10; Dunn & Fennell, supra note 99.

123. Wright, supra note 10, at 818.

124. Id.

125. Id.
the WTO Agreement on Subsidies and Countervailing Measures.\textsuperscript{126} The USTR concluded:

Based on a thorough review of the economic data, other facts, and legal arguments set out in the petition, the interagency committee unanimously recommended that the USTR not accept the petition because a dispute based on the information and arguments set out in the petition would not be effective in addressing the Canadian subsidies.\textsuperscript{127}

Although the U.S. federal government has identified runaway production as an issue to be addressed, it has so far declined to pursue remedies through international trade laws.

It is also important to note the position of the MPAA regarding foreign tax incentives. The MPAA has taken the position that Canadian film and television incentives are not inconsistent with the WTO Agreement on Subsidies and Countervailing Measures.\textsuperscript{128} The MPAA is comprised of MNCs that benefit from foreign MPIs, namely, the six major U.S. motion picture studios—Walt Disney Studios Motion Picture, Paramount Pictures Corporation, Sony Pictures Entertainment, Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLC, and Warner Bros. Entertainment Inc.\textsuperscript{129}

**B. Individual U.S. States: More Positive Carrots**

1. **Amount of Film and Television Tax Incentives Provided by Individual States**

   In 2003, five states in America provided a total of $2 million in film and television tax incentives. This increased to forty states providing approximately $1.4 billion in film and television incentives in 2010.\textsuperscript{130} It was reported that between 2001 and 2010 individual states with such policies provided a total amount of approximately $6 billion, with almost $4 billion provided between 2007 and 2010.\textsuperscript{131} By way of comparison, three provinces of Canada that represented over 90\% of the tax incentives provided by all provinces in 2003 reported

\begin{itemize}
  \item \textsuperscript{126} Id.; see also Dunn & Fennell, supra note 99.
  \item \textsuperscript{127} Press Release, Gretchen Hamel, supra note 10.
  \item \textsuperscript{128} Wright, supra note 10, at 802.
  \item \textsuperscript{129} Frequently Asked Questions, MPAA, available at http://www.mpaa.org/faq; see supra Part II.C.
  \item \textsuperscript{130} Henchman, supra note 10.
  \item \textsuperscript{131} Id.
\end{itemize}
that they provided a total amount of film and television incentives of approximately $466 million in that year alone.\textsuperscript{132} Between 2001 and

\begin{flushleft}
2010, the five provinces of Canada providing over 95% of the provincial tax incentives reported that they provided a total amount of approximately $4.9 billion, with approximately $3.88 billion provided between 2007 and 2010. The latter expenditures by Canada are limited to providing a broad reference regarding the decisions of Canadian provincial governments because expenditures in certain years were not reported by certain provinces and, further, the exact amounts of the available incentives that were accessed by U.S. runaway productions are unknown. Nevertheless, it is a reasonable conclusion that a relatively competitive amount of available film and television tax incentives were available between 2007 and 2010 from individual states in America vis-à-vis the Canadian provinces, marked by a dramatic increase in the amount available from individual U.S. states beginning in 2007.

2. State Film and Television Tax Incentives Have Been Expensive and Have Not Solved Runaway Production

Since 2010, academic articles and articles by private research organizations have questioned the wisdom of individual U.S. states’ billion-dollar expenditures for film and television tax incentives. These articles often rely on studies published by the state governments that began appearing in 2005, with conclusions that the economic benefits of the film and tax incentives provided by each such respective state’s legislature are significantly outweighed by the costs. There are a number of reasons the studies and articles have reached similar conclusions about the costs versus benefits of film and television incentives provided by individual states. What is relevant for this article is whether the amounts collectively offered by the states reduced the number of runaway productions. Unfortunately, no available study provides a concrete answer to this question.

MANITOBA MINISTER OF FINANCE, BUDGET: TAXATION ADJUSTMENTS 1 (2000) (no film and tax credit reported in 2003); not available for the province of Alberta.

133. Id.

134. McDonald, Down the Rabbit Hole, supra note 10, at 109; Schonauer, supra note 10; Luther, supra note 10; TANNENWALD, supra note 10; Henchman, supra note 10.

135. See GREG ALBRECHT, STATE OF LA. LEGISLATIVE FISCAL OFFICE, FILM AND VIDEO TAX INCENTIVES: ESTIMATED ECONOMIC AND FISCAL IMPACTS 3, 6 (2005) ("[T]he economic benefits are not sufficient to provide tax receipts approaching a level necessary to offset the costs of the tax credits that stimulated the increased film production expenditures."); WISC. DEP’T OF COMMERCE, COST BENEFIT ANALYSIS OF WISCONSIN FILM TAX CREDIT PROGRAM, supra note 10; COMMONWEALTH OF MASS., DEP’T OF REVENUE, A REPORT ON THE MASSACHUSETTS FILM TAX INCENTIVES (2009); AN ANALYSIS OF TEXAS ECONOMIC DEVELOPMENT INCENTIVES, supra note 10.
However, if U.S. film and tax incentives (positive carrots) are to be considered a solution to runaway production then it would be a reasonable position to expect that Canada would report a certain amount of reduced FLS by U.S. producers between 2007 and 2010 as a result of the dramatic increase of available film and television tax incentives in the individual states. This is not what was reported by Canada, that is, FLS in Canada. The percentage of FLS represented by U.S. producers, remained relatively constant between 2007 and 2010. As noted in Part III.B., it is a common criticism of positive carrots that they provide incentives for a party to act in a manner in which that party would have acted even if no incentives were available. As argued elsewhere, there are a finite number of studio (MNC) films produced each year and that finite number will be divided into those that undertake production within the United States and those that decide to film outside the United States; any incentives available within the United States will simply reduce the costs for those films that are in the United States, but will not necessarily influence the overall numbers of film and television productions that plan to remain in the United States for production. Positive carrots provided to compete with foreign MPIs not only cost U.S. federal and state governments by reducing tax receipts, they also have not solved the runaway production problem.

V. U.S. International Tax Laws and Tax Avoidance

A. Background

The U.S. government and other researchers have been unanimous in concluding that U.S.-based MNCs have avoided paying billions of dollars in taxes to the United States annually. Numerous studies


137. See supra note 63 and accompanying text.

138. Luther, supra note 10, at 12; TANNENWALD, supra note 10, at 7; McDonald, Down the Rabbit Hole, supra note 10, at 89.

139. See PRESIDENT'S TAX REFORM, supra note 5; INTERNATIONAL COMPETITIVENESS, supra note 5; Hines, Tax Policy, supra note 5; Taxation New Evidence, supra note 5; TAX HAVENS, supra note 5; Shapiro, supra note 5; Graetz, supra note 5; Thompson, supra note 5; Barker, supra note 5; Fleming, Peroni & Shay, Exemption System, supra note 5; Fleming, Peroni & Shay, Curtailing Deferral, supra note 5; Fleming, Peroni & Shay, Worse than Exemption, supra note 5; Avi-Yonah, supra note 5.
have shown how these taxpayers have been able to obtain such favorable tax results.\textsuperscript{140} Subsidies provided by the U.S. government to MNCs through the U.S. international tax laws and MNCs' ability to successfully exploit the U.S. tax laws regarding their international activities are two reasons often cited.\textsuperscript{141} Due to these reasons, there have been numerous proposals to amend the U.S. international tax laws and eliminate the positive carrots (subsidizations) imbedded within the U.S. tax laws.\textsuperscript{142} Although subsidies have not been identified as an international tax law problem, the following section will reveal exactly how the problem of runaway production by MNCs is an international tax issue.

Recognizing this, a White House press release in 2009 demonstrates that it is an important policy issue:

There is no higher economic priority for President Obama than creating new, well-paying jobs in the United States. Yet today, our tax code actually provides a competitive advantage to companies that invest and create jobs overseas compared to those that invest and create those same jobs in the [United States]. In addition, our tax system is rife with opportunities to evade and avoid taxes through offshore tax havens: In 2004, the most recent year for which data is available, U.S. multinational corporations paid about $16 billion of U.S. tax on approximately $700 billion of foreign active earnings—an effective U.S. tax rate of about 2.3%.

The bottom line is that the current U.S. tax laws already create an economic advantage for MNCs to move capital, investments, and operations outside the United States without piling on tax incentives such as film and television production subsidies and rebates received from foreign countries.\textsuperscript{144} U.S.-based MNCs exploit the differences between U.S. and foreign tax laws in several ways. For example, U.S.-based MNCs exploit the international tax advantages they gain

\textsuperscript{140} Id.
\textsuperscript{141} Id.
\textsuperscript{142} Id.

\textsuperscript{144} See Avi-Yonah, \textit{supra} note 5; Fleming, Peroni & Shay, \textit{Worse than Exemption}, \textit{supra} note 5.
through "deferral" and foreign tax credits; they take advantage of their ability to mismatch foreign expenses with U.S. income, and they take advantage of their ability to cross-credit foreign tax credits. The salient feature is that the tax incentives for film and television production obtained by a U.S.-based MNC from a foreign country (i.e., for being a runaway production) represent money received from the foreign government in addition to the tax benefits provided by the U.S. government to MNCs' worldwide activities by virtue of current subsidies. The degree to which MNCs have benefitted from tax incentives for film and television production by transferring production to foreign countries has been well documented. What must be examined is the way these MNCs exploit additional positive carrots from the U.S. government via U.S. tax laws, which encourage them to move their capital, investments, and operations (i.e., runaway production) to other countries.

This examination must begin by understanding that a government can either tax its citizens on their worldwide income or solely on the income that they earn within their own country. The U.S.'s system provides that citizens (e.g., MNCs such as Walt Disney Co., Sony Corp., CBS Corp., Comcast Corp., and News Corp.) are taxed based on income they earn worldwide. There are countries that do not tax their citizens based on their residence in that country, but rather, based on the source of where the income is earned. That is, they only tax their citizens on the income they earn in the home country, effectively exempting from taxation the income they earn in other countries. On the other hand, every country taxes income earned within their country whether or not it is earned by a citizen or non-citizen. So where income is earned serves as a basis for all countries to tax both residents and non-residents doing business in their

145. See supra Part II.

146. The following overview of certain basic principles of U.S. international income taxation, simplified for brevity and clarity: see JOINT COMM. ON TAXATION, REPORT TO THE HOUSE COMMITTEE ON WAYS AND MEANS ON PRESENT LAW & SUGGESTIONS FOR REFORM SUBCOMMITTEES TO THE TAX REFORM WORKING GROUPS 223–260, JCS-3-13, (Joint Comm. Print 2013) for a more comprehensive overview of the U.S. international tax laws.


148. OPTIONS FOR TAXING, supra note 5, at 1.

country. In essence, U.S. citizens are taxed twice on income earned in other countries. They are taxed once by the United States based on worldwide taxation, and again by the country in which it was earned based on that country’s claim to tax such income earned within its borders. To eliminate this “double taxation”, the United States provides its citizens an income tax credit for U.S. taxes paid to the foreign country equal to at most the amount that would be owed under U.S. tax laws. This tax credit is labeled the “foreign tax credit” or “FTC.” However, the foregoing system is not applicable when a multinational corporation operates through a subsidiary in a foreign country. In this situation, a parent U.S.-based MNC does not pay tax on the foreign subsidiaries’ earnings unless and until the foreign subsidiary repatriates the earnings home, often through a dividend to the parent MNC. This aspect of U.S. international tax laws is commonly called “deferral.”

B. Deferral

The economic advantage of deferral accrues to a U.S.-based MNC because of the time value of money; money that would otherwise be paid to the U.S. government as taxes remains with the foreign subsidiary so that the subsidiary can use it to earn more money by reinvesting in new projects. An example of how U.S.-based MNCs in Canada are subsidized by deferral is illustrated in the table below which is based on a table created by the Congressional Budget Office.

150. Id.
151. OPTIONS FOR TAXING, supra note 5, at 1.
152. Id.
153. Foreign Tax Credit (“FTC”) should not be confused with the Federal Trade Commission.
155. UNITED STATES PRESIDENT’S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA’S TAX SYSTEM 103 (2005).
156. OPTIONS FOR TAXING, supra note 5, at 7.
In the above example, the foreign-owned subsidiaries based in Canada obtain $45 million dollars of deferral in the current year to reinvest in future projects. As of 2011, it is estimated that foreign-owned subsidiaries have between $1 trillion and $1.5 trillion of permanently reinvested earnings. This raises the question as to whether or not (and to what degree) U.S.-based MNCs presently

157. INTERNATIONAL COMPETITIVENESS, supra note 5, at 6 (citing $1.3 trillion based on a study by JP Morgan); OPTIONS FOR TAXING, supra note 5, at 11 (“Some analysts estimate, on the basis of a review of the financial data of 880 companies, that as of May, 2011, unrepatriated foreign income totaled $1.4 trillion.”); see also Susan C. Morse, A Corporate Offshore Profits Transition Tax, 91 N.C.L. REV. 549, 594 (2013) (citing DAVID ZION, AMIT VARSHNEY & NICOLE BURNAP, CREDIT SUISSE, PARKING EARNINGS OVERSEAS 1 (2011) in which they estimated the amount to be $1.3 trillion).
operating in Canada have been receiving the benefit of the positive carrot provided by deferral. That U.S.-based MNCs in the film and television industry have the potential to utilize the benefit of deferral in Canada is made clear by a report that six foreign controlled distributors obtained approximately $1.38 billion of the total Canadian distribution revenues in 2009.\footnote{158}{NORDICITY, STUDY OF THE AUDIOVISUAL DISTRIBUTION SECTOR IN CANADA 6 (2011), available at http://www.pch.gc.ca/eng/1358776472905/1358776512521 states that:}

Although deferral of taxes on foreign income is clearly a benefit to recipients, the reasons why deferrals are provided to U.S-based MNCs need to be explored to determine if deferral is in fact a positive carrot in the U.S. tax code. Deferral is not a recent addition to the I.R.C., but has been part of U.S. international tax policy since 1913. It was based on the initial rationale that taxes should not be imposed on revenues until such funds were actually available to the taxpayer.\footnote{159}{Beginning in the early 1960s deferral started to be attacked as inefficient, unnecessary and expensive. However, proponents of deferral argued that U.S.-based MNCs would be at a competitive disadvantage against foreign MNCs when operating outside of the United States.\footnote{160}{Id; see also Keith Engel, Tax Neutrality to the Left, International Competitiveness to the Right, Stuck in the Middle With Subpart F, 79 TEX. L. REV. 1525, 1538-39 (2001) ("The Kennedy Administration, with the guidance of Stanley Surrey as the Assistant Secretary of Tax Policy, also proposed that deferral for U.S.-owned foreign subsidiaries be largely eliminated so that domestic investment would receive full tax parity with foreign investment.").}} Today the U.S. government and commentators consider deferral an unsupportable position and have

\begin{itemize}
\item \footnote{158}{NORDICITY, STUDY OF THE AUDIOVISUAL DISTRIBUTION SECTOR IN CANADA 6 (2011), available at http://www.pch.gc.ca/eng/1358776472905/1358776512521 states that:}
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\end{itemize}
proposed many reforms that would eliminate it for foreign income earned by foreign subsidiaries of domestic companies.\textsuperscript{162}

\section*{C. Foreign Tax Credits and Mismatching of Foreign Expenses with U.S. Income}

There are two basic constraints on a claim for a tax credit on a U.S. tax return for tax amounts paid to foreign governments.\textsuperscript{163} First, the FTC is limited to the amount of tax that would be owed if such foreign amounts were subject to U.S. tax rates. The purpose of this is to eliminate the possibility of the United States subsidizing countries that have higher tax rates.\textsuperscript{164} It is true that a U.S. taxpayer is allowed to cross-credit foreign taxes paid by deducting tax amounts paid to high tax countries against taxes paid to low tax countries, thereby reducing the U.S. tax due of foreign income.\textsuperscript{165} However, a second limitation is that the ability to cross-credit is allowed only among foreign taxes that occur within similar types (or "baskets") of income.\textsuperscript{166} The categories have been amended over the years but there are currently two baskets within which foreign income is placed: general income ("active" income) and "passive" income. Cross-crediting operates as a subsidy for foreign investment. By allowing a U.S. taxpayer to credit foreign taxes higher than the U.S. rate on some types of foreign-source income against the U.S. residual tax on other types of low- or zero-taxed foreign-source income, the United States is essentially giving the U.S. taxpayer a grant in the amount of the U.S. residual tax eliminated.\textsuperscript{167}

It is important to understand the reasons for allowing FTCs and cross-crediting as related to taxes paid to foreign governments. Accounting for foreign taxes was initially available as a deduction in the 1913 tax code but an unlimited foreign tax credit was added in

\begin{itemize}
\item \textsuperscript{163} See I.R.C. §§ 901–903 (2013); Fleming, Peroni & Shay, \textit{Worse than Exemption}, \textit{supra} note 5, at 132 ("The foreign tax credit is in the form of a dollar-for-dollar offset of qualifying foreign taxes [so-called creditable taxes] against the taxpayer's pre-credit U.S. tax liability.").
\item \textsuperscript{164} \textit{Options for Taxing, supra} note 5, at 5.
\item \textsuperscript{165} \textit{Id.} at 8.
\item \textsuperscript{166} Fleming, Peroni & Shay, \textit{Worse than Exemption, supra} note 5, at 132–33.
\item \textsuperscript{167} \textit{Id.} at 134.
\end{itemize}
The goal was and still is to prevent double taxation of income earned in foreign countries while ensuring that such foreign income does not completely escape taxation. Pursuit of these latter goals was based on the principles of fairness and equity as well as competitiveness. Before FTCs, taxpayers earning income abroad were not being treated as equals with those earning income in the United States. Allowing income to be taxed twice would effectively burden U.S. producers competing in foreign countries where taxpayers would not be subject to such double taxation. The United States has inserted the elimination of the double taxation requirement into many of the bilateral income tax treaties that it has entered into with other countries that have also agreed to relieve double taxation. Although proposals to reduce subsidization available through cross-crediting FTCs by reducing the credit to a deduction as well as other means have been suggested, amending the FTC provisions in the law has been a challenge.

The issue acquires another layer of complexity because MNCs are able to manipulate the tax system to reduce their U.S. tax liability by virtue of the so-called mismatching of foreign expenses with U.S. income. The Congressional Budget Office explains:

When determining (U.S. tax) liability before tax credits, firms need not differentiate between domestic and foreign expenses; all foreign expenses can be deducted entirely against U.S. taxable income to reduce total U.S. tax liability. Thus, expenses from foreign operations reduce U.S. tax liability, even before the application of the foreign tax credit. Moreover, the parent firm can take deductions for expenses it incurs for its foreign operations in the year that those

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168. Gravelle, supra note 159 at 327 n.16 (also providing a brief history of the tax laws regarding foreign taxes).
169. Graetz, supra note 5, at 331.
170. Id. at 296–97.
171. Id.
172. Morse, supra note 157, at 549, 564; see INTERNATIONAL COMPETITIVENESS, supra note 5, at 4–5 (stating the United States has entered approximately sixty-seven bilateral income tax treaties).
173. See Daniel Shaviro, The Case Against Foreign Tax Credits, 3 J. LEGAL ANALYSIS 65 (2011) (exploring a deduction for foreign taxes paid in addition to a reduced tax rate for foreign source income); OPTIONS FOR TAXING, supra note 5, at 19 (recommending a disallowance of cross crediting by limiting the amount of foreign tax credits allowed from each country); INTERNATIONAL COMPETITIVENESS, supra note 5, at 10–11 (recommending four paths to further limiting cross-crediting of FTCs).
expenses are incurred—even if the related foreign income is not repatriated until a later year.\textsuperscript{174}

It is difficult to avoid drawing the conclusion that MNCs are well subsidized by U.S. tax laws when they move operations and business outside the United States where they can utilize deferral, FTCs, cross-crediting FTCs and mismatching foreign expenses with U.S. income. However, the foregoing examples are only a few of the methods available to MNCs operating abroad. When viewed cumulatively, it has been shown that with skillful tax planning, MNCs can not only reduce their U.S. tax on foreign income to zero for certain income, but can effectively be subsidized by U.S. tax laws when operating in foreign territories.\textsuperscript{175}

D. Runaway Production Companies' Exploitation of the U.S. International Tax Laws

The degree to which entertainment companies engaging in runaway production are able to exploit the U.S. international tax laws is an issue that needs to be addressed. The precise answer would have to be obtained directly from these companies, and unfortunately that information is not publicly available. The best that a researcher can do to answer the question is to examine information that is publicly available. It has been reported that the following entertainment MNCs have subsidiaries in countries that provide motion picture and television incentives: Viacom, Inc., Comcast Corp., News Corp., Time Warner, Inc., The Walt Disney Co., and Sony Corp.\textsuperscript{176} Looking at the issue from a wider perspective, the Government Accountability Office issued a report indicating that

\textsuperscript{174} OPTIONS FOR TAXING, supra note 5, at 9–10.

\textsuperscript{175} See Fleming, Peroni & Shay, Worse than Exemption, supra note 5.

eighty-three of the hundred largest publicly traded U.S. corporations (in terms of 2007 revenue) reported having subsidiaries in jurisdictions listed as tax havens or financial privacy jurisdictions. Among these eighty-three corporations are Comcast Corp., News Corp., Time Warner, Inc., and The Walt Disney Co. Furthermore, articles written by leading tax legal counsel to entertainment companies recommend that companies engaged in film and television production and distribution should take advantage of the U.S. international tax laws in order to pay less tax to the United States. Thus, one can reasonably conclude that MNCs engaged in runaway production know the tax opportunities available for doing business abroad, and it is also reasonable to conclude that they take advantage of them. Through the U.S. tax laws, the U.S. government subsidizes taxpayers who do business in foreign countries by foregoing U.S. tax receipts based on reasons such as equity, competitiveness of U.S. companies, and income tax timing issues (that is, the inability to pay U.S. tax when earned abroad). However, the underlying basis of the U.S. government providing such positive carrots is perverted when U.S. MNCs are lured to a foreign country to spend money on production on the basis of MPIs provided by the foreign government as well.


178. Id. Viacom, Inc. and Sony Corp. have also reported that they have subsidiaries in tax havens or financial privacy jurisdictions. See Annual Report, VIACOM, INC., supra note 170 (Netherlands, Switzerland, Bahamas, Cayman Islands); see also Corporate Information, Affiliated Companies (Consolidated Subsidiaries), SONY CORP., supra note 176 (Switzerland, Singapore).


180. See Jason Garcia, Disney Triples Offshore Profits, Saving On U.S. Taxes, ORLANDO SENTINEL (Dec. 9, 2013) available at http://articles.orlandosentinel.com/2013-12-09/business/os-disney-iffshore-profits-taxes-20131206_1_walt-disney-world-u-s-senate-profits (reporting that in 2013 the Walt Disney Company tripled the amount of foreign profits it is keeping in offshore subsidiaries to a total amount of $1.5 billion).

A. The Need For Reform

The conclusion drawn in Part V has been affirmed by many scholars, commentators, and legislators who have also concluded that the U.S. tax laws are too generous to U.S.-based MNCs operating abroad, and that U.S. tax laws should be amended to correct the situation. However, a few other questions need to be addressed before reform can be suggested. First, how has the U.S. government's decision to extensively subsidize U.S.-based MNCs' foreign economic activity affected U.S. tax revenue? Second, how does runaway production fit within the current positive carrots provided by the U.S. government through U.S. international tax laws? And third, does U.S. tax policy require amendments to the U.S. international tax laws to address runaway production?

The first answer is that the U.S. tax base is extensively reduced by the current subsidization of economic activity outside the United States by its international tax laws. In addition to the estimated effective tax rate of 2.3% that MNCs paid on active foreign earnings in 2004, reports estimate that in 2008, approximately 12% of all federal revenue came from corporate income taxes, approximately half of which was paid by MNCs reporting income from other countries. Also, 7% of all federal revenue came from corporate income taxes in 2009 and 10% in 2012. In addition, reports show that if the United States ended deferral, it would collect approximately $114 billion in taxes between 2012 and 2022. If the United States reduced cross-crediting of FTCs by determining them

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181. See notes 140-45 and accompanying text.
182. See Barker, supra note 5, at 651, 652:

A critical reason behind the international trend toward the alternative of a foreign business income (territorial) exemption system is that territorial exemption is perceived to be a more effective way of identifying and preserving the domestic tax base. Economic projections, to the effect that an exemption system is expected to substantially raise revenue as compared to present law, seem to confirm this.

Id.
183. See note 143 and accompanying text.
184. OPTIONS FOR TAXING, supra note 5, at 1.
185. Id.
186. Id. at 18.
based on the share of aggregate earnings repatriated from each
country then the United States would collect approximately $57
billion more in taxes during the same years. The answer to the
second question—how this affects runaway production—is that the
U.S.-based MNCs that are lured to foreign locations are being further
subsidized beyond the extensive subsidization (positive carrots) that
the U.S. government provides via U.S. international tax laws. The
answer to the third question—namely, are reforms to the U.S. tax
code required to ameliorate the imbalance—is that U.S. international
tax policy analysis results in the conclusion that foreign MPIs that
U.S.-based MNCs receive (positive carrots) when moving their
operations and expenditures to foreign countries to produce their film
and television projects require the U.S. government to address the
impact they have on the positive carrots additionally provided to
them by U.S. international tax laws.

B. Proposed Reform

My proposal is that U.S. tax law should require a dollar-for-dollar
elimination of the tax incentives that U.S.-based MNCs receive from
foreign countries when moving capital, investments, and operations
outside the United States in the form of runaway production. The
dollar-for-dollar reduction originates from the current benefits U.S.-
based MNCs receive from the U.S. international tax laws when
moving offshore as described in Part V. The reduction is also based
on the tax policy conclusions reached here. This proposal is
essentially a dollar-for-dollar withdrawal of the positive carrots the
U.S. government currently provides U.S.-based MNCs through the
U.S. tax code based on equity, competitiveness, and other
arguments. In the simplest terms, when moving capital,

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187. Id. at 19. See supra Part V.A., B., and C.
188. See supra Part V.
189. Supra Part V.
190. See generally Reuven S. Avi-Yonah, The Three Goals of Taxation, 60 TAX L.
     REV. 1, 24 (2006) stating:

     This, then, is the third goal of taxation: regulation of private sector
     activity by rewarding activities that are considered desirable (via
deductions or credits) and deterring activities that are considered
undesirable (via increased taxation). A major portion of the current
Code can only be understood as fulfilling this regulatory function.

Id.
191. See supra Part V.
investments, and operations abroad, U.S.-based MNCs can utilize the generous positive carrots currently provided by the U.S. government through U.S. international tax laws. But if they additionally take MPIs provided by foreign governments, then they should not receive the full amounts of the positive carrots currently provided through the U.S. tax code to the degree necessary to achieve the goals stated in this article.

C. U.S. International Tax Policy

The analysis supporting the above conclusion can begin with identifying the reasons why the U.S. government taxes its citizens. Several reasons have been identified by scholars, including two primary reasons that are important regarding runaway production. The reasons include the ability of a government to raise revenue and a government’s desire to influence its taxpayers’ behaviors. Tax policy is further complicated when addressing international tax laws because several other factors also affect a government’s ability to tax and influence the behavior of its citizens. Some factors include: (1) world monetary policies and resulting exchange rates, (2) the tax systems of other countries, (3) the tax treaties the United States has entered with many countries, (4) the tax rates other countries offer, especially if these rates are lower than the tax rates of the United States and, (5) international trade concerns and laws. International tax policy is generally an attempt by a country to balance the level of tax paid to the taxpayer’s home country vis-à-vis the tax revenue that the home country allows to be paid to foreign countries (at the expense of home country revenue), while imposing these taxes with

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193. Avi-Yonah, supra note 190, at 3, 22 (revenue-raising function of taxes, the redistributive function of taxes and the regulatory power of taxes). Starting in 1918, “the United States began a long series of [tax] measures designed to reward some forms of corporate activity and deter others.” Id. See also Galle supra note 192, at 1346 (noting “that a tax system can serve several different functions.”); Martinez, supra note 192, at 415–16 (noting the revenue raising function in addition to supporting stable economic growth and “as a vehicle of social and economic policy”); see supra Part III. regarding the government’s ability to influence citizens’ choices.

efficiency and fairness. Scholars have developed the framework of efficiency, equity (fairness), and administrability in order to evaluate competing tax policy goals. This classic framework will be utilized to reform current international tax laws for runaway productions.  

1. Efficiency

Economists most often measure efficiency by evaluating how resources are allocated and used, whereas tax policy analysis measures efficiency by evaluating the extent to which taxes influence the economic decisions of those affected by such laws. One of the criteria used to measure such economic decisions is whether or not any deadweight loss has occurred by virtue of decisions made under the influence of the tax laws. Put simply, deadweight losses are incurred when resources are used in less economically productive ways in response to the money that can be obtained from tax avoidance. Inefficient taxes create deadweight losses while efficient taxes do not; obviously, the greater the response a taxpayer has to an inefficient tax, then the greater the deadweight loss. As generally applied to runaway production, the extent to which taxpayers would not move capital and operations to foreign countries if they did not


In this article, I demonstrate that tax policy is a largely mythical concept, more akin to the Holy Grail than to anything else. Tax policy more nearly describes an ideal than it describes a normative principle. I conclude that self-interest, irrationality, and ineptitude explain the vicissitudes of tax policy in the modern world.

Id.


197. Morse, supra note 157, at 567; Lazerow, supra note 196, at 1132; Zolt, supra note 196, at 61; but see Nguyen & Maine, supra note 195, at 5–6 (noting economic growth as an alternative measurement of tax efficiency, that is, a finding of an efficient tax system where it promotes economic growth and an inefficient tax system if it does not).

198. Morse, supra note 157, at 567; Shapiro, supra note 5, at 149 n.33; David Elkins, Horizontal Equity as a Principle of Tax Theory, 24 YALE L. & POL'Y REV. 43, 47 (2006).

199. Id.

200. Elkins, supra note 198, at 47; Zolt, supra note 196, at 63.
receive tax incentives is the extent of deadweight loss that can be associated with their decision to do just that, thereby making such tax policies (that is, the provision of tax incentives) inefficient.

The analysis of efficiency within international tax law is more complicated than the aforementioned general principles, and certain theories have been developed to assist the analysis. These theories are based in neutralities that seek to isolate tax policies to evaluate each policy's effect on efficiency. Since all taxes, to some extent, are inefficient, it raises the questions of when they are inefficient and to what degree are they inefficient. Although empirical research regarding the latter questions has not produced universal bright line answers when applied to taxpayers' decisions for investing capital in domestic or foreign locations, there are broad conclusions that can be made from the research that has been done. Three basic conclusions are discernible: first, a primary goal of U.S. international tax policy has been to maximize wealth or utility; second, it is clear that taxes definitely do influence taxpayers' decisions regarding the location of capital investments; and third, "targeted tax incentives are not neutral and are inefficient."

The five theories of efficiency that have been developed based on neutralities provide broad structures that can be applied to a tax system or to a specific tax law to evaluate its efficiency, and they are the benchmarks that have assisted scholars in reaching the above three conclusions. These benchmarks are: (a) capital export neutrality ("CEN"), (b) capital import neutrality ("CIN"), (c) national neutrality ("NN"), (d) national ownership neutrality ("NON"), and (e) capital ownership neutrality ("CON"). Since the 1960s, these theories, or benchmarks, have been the primary

201. See Barker, supra note 5, at 655.
202. Shapiro, supra note 5, at 161.
203. Graetz, supra note 5, at 270 n.30 (citing historical examples by the U.S. government).
204. Taxation New Evidence, supra note 5, at 22; Hines, Tax Policy, supra note 5.
205. Barker, supra note 5, at 655.
206. See Gravelle, supra note 159, at 327 n.15. The first three of these concepts are generally attributed to Peggy Richman Musgrave. See generally PEGGY B. MUSGRAVE, UNITED STATES TAXATION OF FOREIGN INVESTMENT INCOME (1969); PEGGY B. RICHMAN, TAXATION OF FOREIGN INVESTMENT INCOME: AN ECONOMIC ANALYSIS (1963). CON and NON are associated with Mihir Desai and Jim Hines. Mihir A. Desai & James R. Hines, Jr., Evaluating International Tax Reform, 56 Nat'L Tax J. 487 (2003). The term CON, however, appears to have been coined by Michael Devereux.
evaluations by which efficiency has been evaluated in international tax law policy.\textsuperscript{207}

(a) CEN. CEN is achieved when an investor makes a decision to invest in a foreign jurisdiction or the investor’s home country without regard to taxation. The investment is taxed the same whether the investment is made at home or abroad.\textsuperscript{208} A primary goal in achieving CEN from tax laws is to design them so that they maximize global efficiency.\textsuperscript{209} Tax incentives that are given around the world for motion picture and television production violate CEN and are inefficient because they induce investors to make investment location decisions based on the preferable tax treatment that will be obtained in the jurisdiction, thereby creating deadweight loss and reducing global efficiency.\textsuperscript{210} U.S. tax law amendments counterbalancing the inefficient motion picture and television production incentives would move the U.S. tax laws closer to CEN, and therefore, would make the U.S. tax laws more efficient.

(b) CIN. CIN is concerned with the equal tax treatment of capital invested in a jurisdiction whether that capital is invested by domestic sources or is brought into the jurisdiction by foreign sources.\textsuperscript{211} CIN is concerned with the efficient worldwide allocation of savings versus consumption and can affect the ability of businesses to compete in foreign jurisdictions.\textsuperscript{212} It has been well settled that absent identical tax rates for every worldwide jurisdiction, it is not possible to design tax laws that achieve CEN and CIN at the same time,\textsuperscript{213} but tax laws must be designed to achieve one or the other, or to create a compromise between their policy goals.\textsuperscript{214} The film and television production incentives available worldwide generally are available to

\textsuperscript{207} Michael S. Knoll, The Connection Between Competitiveness and International Taxation, 65 Tax L. Rev. 349, 368 (2012); but see Shapiro, supra note 5, at 163 (noting critiques of these benchmarks).
\textsuperscript{208} Graetz, supra note 5, at 270.
\textsuperscript{209} Id.
\textsuperscript{210} Knoll, supra note 207, at 368; see Graetz, supra note 5, at 325 (“From the perspective of CEN, which abhors tax-induced distortions in the location of investments, any tax-induced shift in the allocation of resources is bad, whether the culprit is U.S. or foreign taxes.”)
\textsuperscript{211} Graetz, supra note 5, at 270.
\textsuperscript{212} Graetz, supra note 5, at 270–71; see Gravelle, supra note 159, at 328, Table 1 (noting that “competitiveness” is an objective in a territorial tax system and CIN is associated with it).
\textsuperscript{213} Gravelle, supra note 159, at 329–30.
\textsuperscript{214} Graetz, supra note 5, at 272, 274 (stating that CEN has been chosen more often than not because of its elasticity).
both foreign capital and domestic capital invested in each country so there is equal treatment of both.

(c) NN. From a practical perspective, perhaps the most important neutrality that is violated by motion picture and television tax incentives is national neutrality ("NN"). This benchmark has been defined as seeking "neutrality between the pretax return on domestic investments and the return on foreign investments after the payment of foreign taxes." Taxpayers that invest in film and television projects in the United States do not receive the tax incentive money that investments in similar projects abroad receive, which increases the return on investment for investments in such foreign jurisdiction. Since the payment of foreign taxes is either deferred, subject to FTCs, cross-crediting of FTCs, and other exploitations of the U.S. international tax laws by MNCs, NN is violated by the U.S. international tax laws in general. The increased return on investment from foreign motion picture and television funds only serves to move U.S. international tax laws even further from reaching the benchmark of NN. The practical implications of the increased violation of NN by incentives from foreign jurisdictions given to U.S.-based MNCs to runaway results in the further loss of U.S. tax revenue collection at a time when "the United States is in a revenue crisis." That is, the tax revenue that would have been paid to the U.S. treasury from an investment is instead lured to a foreign jurisdiction and contributed to the treasury of the foreign nation providing the motion picture incentives. As stated above, the current conclusions by scholars, commentators, and legislators are that the U.S. tax laws are generally too generous to MNCs operating abroad and should be amended to obtain more tax revenue for the United States. Film and television incentives that decrease U.S. tax revenue by luring

215. Graetz, supra note 5, at 274.
216. See Avi-Yonah, supra note 5, at 1607–08; Fleming, Peroni & Shay, Worse than Exemption, supra note 5, at 98; Shaviro, supra note 173, at 70–73.
217. Id.
218. Clifton, Fleming, Peroni & Shay, Designing a U.S. Exemption System, supra note 5, at 400, 459 (discussing the possible structures of a territorial or exempt international tax system, noting that "because of the U.S. fiscal situation, it is particularly important that a U.S. territorial system not forgo more revenue than is necessary to achieve the system's appropriate ends").
219. See supra note 139 and accompanying text.
220. See Avi-Yonah, supra note 5, at 1587; Fleming, Peroni & Shay, Worse than Exemption, supra note 5, at 85, 149; INTERNATIONAL COMPETITIVENESS, supra note 5, at 4–6; PRESIDENT'S TAX REFORM, supra note 5, at 2, 9–10; Shaviro, supra note 173; OPTIONS FOR TAXING, supra note 5, at 1, 11.
U.S.-based capital investments abroad violate NN. The proposed amendment to counterbalance these foreign incentives would move U.S. tax laws closer to NN, which is a stated goal of what generally needs to be accomplished with amendments to the U.S. tax laws.\(^{221}\)

**(d) NON.** Tax laws that meet the NON standard generally do so under a similar definition to NN.\(^{222}\) Therefore, the conclusions regarding foreign motion picture and television incentives’ inefficiency under NN are unchanged under the analysis of NON.

**(e) CON.** “A tax system that satisfies CON is one in which companies, regardless of where they are based, compete on an equal footing in seeking to acquire productive assets. Tax considerations will not advantage or disadvantage any of them in their ability to acquire productive assets.”\(^{223}\) This neutrality is violated if ownership of an asset is determined because of tax considerations, since it would be moving the ownership of an asset away from its most efficient owner.\(^{224}\) Receiving foreign film and television incentives generally requires the recipients to own the copyright of the underlying project, or to have a written contract to provide production services to the copyright owner.\(^{225}\) In general, the lack of a requirement of copyright transfer to the country providing the incentive in order to obtain such country's MPI does not support a finding that these incentives violate the CON neutrality. However, it is unknown if U.S.-based MNCs are in fact transferring the copyright ownership to the foreign subsidiaries that are receiving the tax incentives which, if proven, would violate CON and indicate a required counterbalancing amendment to U.S. tax laws.

Legislators with an understanding of efficiency metrics and the concerns outlined herein have enacted U.S. international tax laws.\(^{226}\)

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221. See Avi-Yonah, supra note 5, at 1588; see also Clifton, Fleming, Peroni & Shay, Designing a U.S. Exemption System, supra note 5, at 458–59; see also INTERNATIONAL COMPETITIVENESS, supra note 5, at 8–9; APPROACHES TO IMPROVE COMPETITIVENESS, supra note 5, at 43–46; PRESIDENT'S TAX REFORM, supra note 5; Shapiro, supra note 5, at 170; See OPTIONS FOR TAXING, supra note 5, at 1, 17.

222. Shapiro, supra note 5, at 164, 166.

223. Knoll, supra note 207, at 368; see Gravelle, supra note 159, at 327 n.15 (reviewing the history of the development of the terms CON and NON).

224. Shapiro, supra note 5, at 164, 165.

225. See e.g., CAN. AUDIO-VISUAL CERTIFICATION OFFICE, PSTC PROGRAM GUIDELINES 10 (2012).

226. Graetz, supra note 5, at 274 states:

It is, for example, now commonplace, whenever international tax issues come before the taxwriting committees of Congress, for the pamphlets of the Staff of the Joint Committee on Taxation to describe a choice or
U.S. international tax policy reflects the favoring of certain neutralities at the expense of others, leading recent evaluations by the U.S. government and scholars to conclude that the neutralities of CEN, CON, and CIN have been emphasized at the expense of NN and NON, thereby necessitating reforms that would generally increase the U.S. tax base with respect to U.S.-based MNCs. On balance, the efficiency metrics favor the elimination of foreign motion picture and television tax incentives because they divert the flow of capital offshore which alters the current balance of neutralities, makes the U.S. international tax laws even less efficient, and further decreases the U.S. tax base and revenue.

2. Equity/Fairness

Professor Michael J. Graetz succinctly stated:

To be sure, thinking about fairness in international taxation complicates both analysis and policymaking. It is frequently controversial even in the domestic context to achieve agreement about the appropriate level or redistributive goals of the income tax, or to assess under what circumstances equity demands equal treatment. When the relevant comparisons are between citizens, residents, and foreigners, the difficulties multiply. Multinational corporations add further complications and controversy. Questions of the appropriate measurement of the tax base and level of tax also become more complex when income is earned transnationally.

In spite of the challenges identified by Professor Graetz, tax policy requires an assessment of fairness when evaluating international tax laws. The first challenge is one of inter-nation equity. A nation has a right to tax its citizens on their worldwide income and each nation has a right to tax activity by foreigners within its nation. As a result, the conundrum of double taxation arises compromise between CEN and CIN as the normative framework through which international tax policy issues should be addressed.

Id.


228. Graetz, supra note 5, at 306.

229. Id.

230. Id. at 298; Clifton, Fleming, Peroni & Shay, Designing a U.S. Exemption System, supra note 5, at 401; Barker, Optimal International Taxation, supra note 194, at 185–86.
which is customarily the responsibility of the nation demanding
double taxation to eliminate.\textsuperscript{231} The United States fulfills this
responsibility by providing its citizens FTCs, restricting any FTC to
the amount of tax paid to the foreign country.\textsuperscript{232} A country asserts its
right to tax activity within its borders based on a "benefits received"
theory.\textsuperscript{233} So a party generating income within that country's borders
utilizes that country's infrastructure, legal system, system of
enforcement of laws, and other resources, and is required to provide
taxes to support such use.\textsuperscript{234} However, when a party has been lured
within those borders with tax incentives, the equity of the benefits
received theory is undermined, that is, the party would not have used
the resources of the foreign country if not for the requirement that
they be physically present in that foreign country in order to receive
tax incentives.

The U.S. government grants FTCs based on equity,\textsuperscript{235} and the tax
incentives that lure U.S. MNCs to foreign countries do not conform
to the underlying equitable reasons for which FTCs are granted.
Therefore, inter-nation equity considerations support the reduction of
the positive carrots provided to U.S.-based MNCs by the U.S.
government through the U.S. tax code when those MNCs take foreign
tax incentives.

How to assess the question of fairness or equity when
approaching tax reform is always perplexing. Historically scholars,
commentators and legislators have examined equity in tax policy
analysis based on "horizontal equity" ("HE") and "vertical equity"
("VE").\textsuperscript{236} The HE standard provides that those in equal positions
should be treated equally, while the VE standard provides that those
who are treated differently should be treated differently based on
appropriate distinctions.\textsuperscript{237} HE and VE have been subjected to
intense academic scrutiny resulting in the prevalent conclusion that
HE is not useful as an independent measurement of equity or fairness

\textsuperscript{232} I.R.C. §§ 901, 903, 904 (2013).
\textsuperscript{233} Fleming, Peroni & Shay, \textit{Worse than Exemption}, \textit{supra} note 5, at 80–81.
\textsuperscript{234} Barker, \textit{Optimal International Taxation}, \textit{supra} note 194, at 199, 209.
\textsuperscript{235} Graetz, \textit{supra} note 5, at 296.
\textsuperscript{237} Staudt, \textit{supra} note 236, at 925; see also Elkins, \textit{supra} note 198, at 43 n.1 (providing
a timeline of the evolution of the horizontal equity principle).
in tax policy. Accordingly, some argue that HE should therefore be abandoned or absorbed into VE, leading to the further prevalent conclusion that VE is not more useful as an independent measurement because it must employ a substantive theory of equity or fairness to obtain an evaluation of these concepts in tax policy. A few of the more prevalent substantive theories scholars have applied when examining VE include: utilitarianism, the benefit theory, ability to pay, and the Rawlsian theory. This article will apply the first three substantive theories to the tax policy recommendation for a reduction of the positive carrots provided to U.S.-based MNCs by the U.S. government through the U.S. tax code when those MNCs take foreign MPIs. However, certain assumptions and omissions must first be addressed.

First, omitting a discussion of the issues underlying HE and VE, this article will accept that HE is not a standard that can be independently applied to tax policy but VE, utilizing a substantive theory of justice, is an appropriate standard. Second, as pointed out by Professor Graetz, HE and VE can best assist the assessment of equity or fairness when applied to individuals, and the proposed equity analysis in this article is applied to MNCs and not individuals. For purposes of this article it is assumed that application of the underlying substantive theories of justice will shed light on the equity/fairness issue as applied to corporations and MNCs, and will omit an analysis of the assumption. A third issue is that there has been a division among scholars as to whether it is proper to have a

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238. Repetti & Ring, supra note 236, at 135 (providing a history and analysis of the recent debates and conclusions on both sides of the debate); Staudt, supra note 236, at 926, 933; Zolt, supra note 196, at 89; but see Elkins, supra note 198, at 88 (concluding that HE and VE are incompatible and tax theorists “must clarify within which framework they are operating and the underlying goal of their theories”).

239. Staudt, supra note 236, at 950–51 (John Rawls “focuses on the rights of individuals under the social contract . . . . According to Rawls’s theory, any policy that impinges upon an individual’s right to equal liberty is problematic.”); Elkins, supra note 198, at 54–55 states:

John Rawls considered equality to be an end in itself, and used it as his starting point in the development of his “difference principle.” The difference principle holds that any deviation from absolute equality in the distribution of primary social goods is justified only if the least well-off in the unequal distribution are better off than they would have been under a more equal distribution.

Id. Since this article is focusing on MNCs, Rawlsian theories will not be applied within the efficiency evaluation. Id.

240. Graetz, supra note 5, at 301–02.
corporate tax at all since taxes are ultimately borne by individuals, whether in their capacity of shareholder, consumer, labor or otherwise. For purposes of this article, it is assumed that a corporate tax is assessed, and further that it is properly assessed on the worldwide income of corporations.

(a) Utilitarianism Theory. The first of the three selected substantive theories mentioned above, utilitarianism, measures changes in policies based on whether they increase or decrease maximum welfare of a society. "Modern utilitarians evaluating tax laws are primarily concerned with the market incentives and disincentives found in the I.R.C." In particular, the inquiry is whether the tax incentives and disincentives are efficient or inefficient; that is, the more inefficient they are, the more market growth and overall wealth should decrease, and the less utility such tax laws provide. To the extent that runaway production occurs because the taxpayers are pursuing tax incentives in foreign countries, then these policies are reducing U.S. society’s overall utility by diverting capital to less productive activities by driving real wages for U.S. workers lower over time and by forcing the participants to incur costs in pursuit of these tax incentives. This diverts further resources from productive activities in the global economy. The fact that the foreign film and television incentives reduce overall utility supports the conclusion that the U.S. tax system would be more equitable if these MNCs do not receive positive carrots from the U.S. government via U.S. international tax laws in addition to the positive carrots they receive from foreign governments for runaway production under the principle of utilitarianism.

(b) Benefit Theory. Put simply, the “benefit theory” holds that the tax level should be commensurate with the benefits received by

241. Id. at 302 states:

Most economists now regard an income tax on corporations as a tax on capital income, borne by suppliers of capital, but the burden of actual corporate income taxes, at least in part, may be borne by consumers and/or workers. It is standard practice in government analyses either to assume the U.S. corporate income tax is split 50-50 by owners of capital and consumers or to treat the incidence of the tax as uncertain.

Id.


243. Staudt, supra note 236, at 943.

244. See supra notes 196–207 and accompanying text; JOINT COMM. ON TAXATION, FACTORS, supra note 161, at 11, 12.

245. See supra Part VI.C.1. for a discussion of efficiency.
each party. The difficulty with this theory lies in how to measure and allocate the benefits received. A benefit evaluation becomes less difficult if the focus is on one group of taxpayers, such as U.S.-based MNCs that receive foreign film and television tax money. Such MNCs not only utilize the basic benefits provided by the U.S. government, which includes the U.S. infrastructure, legal system, system of enforcement of laws, and other resources, but they also have been insistent that the U.S. government take special actions on its behalf regarding its business endeavors. For example, the MPAA, comprised of the six major U.S. studios and subsidiaries of the MNCs that represent the most significant amount of runaway production, consistently and successfully lobbies the U.S. government to act in its interests spending sums of money wholly disproportionate to its size. Among other things, the MPAA lobbies issues regarding foreign trade relations and “multilateral trade agreements such as GATS, TRIPS, and the Convention on Cultural Diversity.” Further, the MPAA utilizes the USTR to file claims against foreign countries on its behalf for alleged international trade violations. In recent years, the MPAA has also enlisted the U.S. government’s resources to combat international piracy of its product. The MPAA has stated:

The six major studios of the MPAA generate billions of dollars annually from filmed entertainment distributed around the globe.... The online theft of creative content is one of the most significant and ubiquitous barriers to the global free flow of information that US industry confronts around the world. To effectively foster legitimate online commerce, the US government must grapple with the massive quantity of stolen content available online and the perception among

247. Id. at 937.
248. See supra Part II.C. regarding the parties that are engaging in runaway production.
250. Lee, supra note 10, at 396.
251. Id.
252. Id. at 380–81; Stephen K. Shiu, Motion Picture Piracy: Controlling the Seemingly Endless Supply of Counterfeit Optical Discs in Taiwan, 39 VAND. J. TRANSNAT'L L. 607, 639–40 (2006) (discussing intellectual property piracy he states “without the USTR, the MPAA, having little leverage alone, probably would not be able to influence any change in Taiwan”).
some consumers that the theft of property online is of little consequence. MPAA strongly supports efforts by the US government to work with trading partners to foster legitimate online commerce, which includes the protection and enforcement of intellectual property rights online.253

Although the MPAA members generate billions of dollars annually around the globe, as has been shown in Part V, very little of that revenue is taxed within the United States.254 Yet, these MNCs demand that the U.S. government grapple with the worldwide theft of their product on their behalf by allocating government resources to address these issues.255 Notwithstanding the measurement and allocation issues regarding these benefits received by these MNCs, it is reasonable to find that the equitable benefit received by them from the U.S. government to address the numerous and costly concerns specific to their business supports a conclusion that they should not receive positive carrots from the U.S. government via U.S. international tax laws in addition to the positive carrots they receive from foreign governments for runaway production. Alternatively, if these MNCs insist on receiving the positive carrots from both the U.S. and foreign governments, then it would seem to be more equitable that they segregate the product that is recipient of such foreign tax money and ask those governments to “grapple with the massive quantity of stolen content available online” on their behalf as well as address any worldwide market access and other trade issues they encounter with this product.

(c) Ability to Pay Theory. The “ability to pay” theory holds that:

Tax systems are fair if the taxes demanded of each taxpayer reflect their actual ability to pay .... Tax systems that allow taxpayers to hide certain types of income via loopholes, income classification, tax shelters, or other schemes, do not accurately impose the tax burden based on taxpayers ability to pay, and are thus less fair.”256
As shown in Part V.B. and Part VI.A., the MNCs engaging in runaway production have a clear ability to pay but the amount of taxes they are paying to the United States are inadequate in comparison to their ability to pay. It is very clear that the U.S. international tax laws allow these MNCs to be generously subsidized thereby enabling them to pay even less tax by engaging in runaway production. This analysis supports the conclusion that under the principle of ability to pay, the U.S. tax system would be more "equitable" if these MNCs do not receive positive carrots from the U.S. government via U.S. international tax laws in addition to the positive carrots they receive from foreign governments for runaway production.

3. Administrability

The classic measure of an "administrable" tax is one that minimizes both the costs of the government to administer the law and the costs of the taxpayer to comply. When taxpayers move capital and operations outside the United States, the process necessary for the United States to collect a tax via the U.S. international tax laws involves complex tax laws requiring both the United States and the taxpayer to expend considerable resources to administer and comply with these laws. Applying administrability to taxation of MNCs that move capital and operations abroad (i.e., runaway film and television production) begins with comparing the administrability of the U.S. tax laws when MNCs spend capital and engage in operations within the United States as opposed to when they spend capital and engage in operations abroad. This is because MNCs must move capital and operations abroad to obtain the film and television tax incentives from the foreign country, removing the revenues generated from U.S. tax laws to foreign tax laws. An exploration of the comparable administrability of U.S. domestic tax laws and U.S. international tax laws is beyond the scope of this article, but neither set of laws is currently praised for its simplicity. In this article efficiency and equity/fairness are given the primary consideration, while administrability is considered to be neutral in the overall examination.

257. See supra notes 143 and 157 and accompanying text; see also Part V.D.


259. Fleming, Peroni & Shay, Curtailing Deferral, supra note 5, at 492 (1999) (in the context of controlled foreign companies and deferral); see also Graetz, supra note 5, at 331; Fleming, Peroni & Shay, Worse than Exemption, supra note 5, at 125–27 (discussing the difficulties of collecting tax under I.R.C. § 482, transfer pricing rules).
of how tax policy relates to motion picture and television tax incentives received from foreign nations. However, the proposed tax amendments presented below do raise administrability issues that will require examination under the classic measure of an administrable tax that may impact the efficiency and equity/fairness conclusions reached above. But as stated above, those considerations are beyond the scope of this article.

D. Implementation of the Proposed Tax Amendment

The above analysis of U.S. international tax policy analysis warrants the conclusion that the U.S. tax laws should be revised in regard to foreign MPIs. The outcome of any revision must be designed to ameliorate the impact of these incentives when they are exploited in conjunction with the extensive subsidies, positive carrots, that MNCs are already provided by the U.S. tax code when moving capital, investments and operations abroad. More specifically, the goal of these revisions would be to achieve a dollar-for-dollar elimination of the MPIs; in order to essentially withdraw an equal amount of positive carrots that the U.S. government currently provides through the U.S. tax code.

To accomplish this goal, the following five amendments are proposed: Proposal 1, the worldwide gross amounts of foreign MPIs received must be added to the final calculation of the taxpayer’s tax owed on its U.S. tax return; Proposal 2, any and all other tax credits that a U.S. taxpayer otherwise receives in calculating its U.S. tax owed must be disallowed up to the worldwide gross amounts of foreign MPIs received; Proposal 3, deferral must be ended for any project that receives any foreign MPIs; Proposal 4, deductions must be disallowed for the U.S. taxpayer up to the worldwide gross amounts of foreign MPIs received; or, Proposal 5, foreign tax credits must be disallowed for the U.S. taxpayer up to the worldwide gross amounts of foreign MPIs received. Each of the proposed revisions has costs and benefits associated with implementation which are discussed below. Proposals 1 and 2 will be evaluated together and Proposals 3, 4, and 5 will be evaluated together.

1. Proposals 1 and 2

Proposals 1 and 2 focus on the U.S. tax return of the taxpayer accepting the foreign MPIs. These proposals would be effective in addressing the runaway production issue based on the fact that the primary recipients of the foreign MPIs are U.S.-based MNCs that have controlled foreign corporations, namely, subsidiaries in the
foreign countries that are providing the MPIs. However, the connection between the U.S.-based taxpayer and the acceptance of the foreign MPIs by another party in the foreign country is a primary issue. The trigger to either Proposals 1 or 2 could be the ownership of the subsidiary that accepts the foreign MPIs or it could be the ownership of the copyright of the project that receives the foreign MPIs, or it could be the "ownership" of the project under an ownership standard already developed in tax law. Taxpayers faced with either Proposal 1 or 2 would most likely react to the new laws by reviewing their ownership of the project in an attempt to circumvent this trigger provision in Proposals 1 or 2. However, to MNCs, ownership principles are currently important for economic reasons such as building a library of intellectual property in addition to being important for other tax determinations. For example, depreciation, sale-leaseback transactions (in which the owner sells the ownership of the project to a foreign party who then leases it back), the determination of whether payments are compensation for services or royalty payments, and whether a transfer of rights to the project are inventory or the transfer of a capital asset. As such, the taxpayer's attempt to avoid ownership to avoid Proposals 1 or 2 would have significant consequences to its economic activities and to its other tax planning methods for a project. To be thorough, Proposals 1 or 2 could be triggered by either the ownership of the foreign subsidiary, ownership of the copyright at any time before principal photography, or ownership as defined under one of the existing tax standards.

The procedures of Proposals 1 or 2 wherein the gross amounts of MPIs received are added to the amount of tax owed or disallowing tax credits the taxpayer otherwise would receive would both be very effective in reaching the goal of a dollar-for-dollar reduction of positive carrots these taxpayers are receiving. Arguably, focusing on the tax paid via the domestic tax return and not the gross receipts of the taxpayer (i.e., adding the foreign MPI amounts to tax owed by the taxpayer and not to its revenue received) may result in more tax paid by the taxpayer when choosing to accept the foreign MPIs than if they didn't choose to accept them. This would be more than a dollar-for-dollar reduction, because of the costs involved in obtaining the foreign MPIs. However, from an effectiveness and administrative perspective it is necessary to focus on the tax owed, especially because the taxpayer has the choice to accept the foreign MPIs or not accept them, with the

260. For example, ownership principles in determining the taxpayer eligible to claim depreciation or capitalization of costs under I.R.C. § 167 (2013).
overall costs associated with accepting them simply to be factored with the attendant benefits from accepting them.

A further issue with the ownership tests could be that taxpayers subject to the new tax laws would move their corporate headquarters, their intellectual property ownership and/or project development outside the United States. However, it is unlikely that the primary taxpayers currently utilizing foreign MPIs—such as Disney, Fox, and other studios—will move their headquarters out of the United States based on the ability to receive foreign MPIs. These MNCs rely on the United States for vital government resources which would be less available if they were no longer U.S.-based organizations. It is also unlikely that these MNCs would move development of the projects outside the United States since the resources they use to develop these projects such as the human resources consisting of executives, writers, actors, and other personnel are located within the United States. Because the time frame of the development process is less defined than principal photography or the editing of a film or television project, it would be more difficult for these taxpayers to move the required human resources outside the United States for indefinite periods of time required to develop each film or television project. It is possible that these taxpayers could move their intellectual property (the ownership of the film and television projects), outside the United States which is currently a primary tax avoidance move utilized by non-entertainment MNCs. A provision

261. See supra Part VI.C.2.(b).

262. See PHINEAS BAXANDALL & ABIGAIL CAPLOVITZ FIELD, UNITED STATES PUBLIC INTEREST RESEARCH GROUP, WHO'S AFRAID OF INVERSION? CONGRESS CAN CLAMP DOWN ON OFFSHORE TAX HAVENS 3 (2013) states:

[C]hanging the designated location of the corporate headquarters is rarely a practical way to go about it. In the last decade Congress has erected several protections that made it very difficult for companies to portray themselves to the IRS as a foreign company while simultaneously maintaining the same level of activity within the United States. Congress has created new laws, and new rules issued by the Treasury on June 7, 2012, raise the bar prohibitively high for most companies.


The first step in shifting profits offshore takes place when a U.S. company games the transfer pricing process to sell or license valuable assets that it developed in the United States to its subsidiary in a low-tax
in the revised law stating that ownership of the copyright at any time before principal photography could be a provision which would counteract the transfer of the project outside the United States after it is developed within the country.

An issue with Proposal 2 might arise if the taxpayer does not have any other tax credits to be disallowed on its U.S. tax return. In this case, the loss of tax credits could be carried forward, but this method is less effective because the U.S. taxpayer could carefully plan not to receive U.S. tax credits indefinitely, thereby circumventing the dollar-for-dollar reduction. In practical terms, this issue may be less of an issue regarding the recipients of foreign MPIs because it is estimated that corporations in the motion picture, broadcasting and telecommunications industries claimed more than $204 million in general business tax credits in 2008.264

Proposal 2 also suffers from a disconnect between the foreign MPIs received and the disallowance of tax credits unrelated to the production of the project. The tax credits that are available to the taxpayer in calculating its U.S. tax owed have been drafted to reflect certain tax policy goals which would be frustrated by their disallowance based on unrelated activities. However, the alternative minimum tax is an example of tax code sections that effectively disallow otherwise allowable tax deductions and credits for reasons unrelated to the tax policy goals that underlie such deductions and credits.265

2. Proposals 3, 4, and 5

Proposals 3, 4, and 5 are tax amendments that are already recommended by scholars, tax experts, bipartisan commissions, members of the U.S. Senate and Congress, and the Obama Administration.266 All are intended to reform the current international tax laws.267 Applying them to runaway production, and

jurisdiction for a price that is lower than fair market.... These transactions transfer valuable intellectual property to wholly owned subsidiaries. Multinational companies and the legions of economists and tax lawyers advising them take full advantage of this situation to set an artificially low sale price to minimize the U.S. parent company's taxable income.

Id.

266. See supra note 5.
267. Id.
more narrowly to the amounts of foreign MPIs accepted by taxpayers who are engaged in foreign film and television production, would be their application to a relatively small segment of U.S. international economic activity. As such, the tax policy concerns that are involved when contemplating the application of these tax reforms to all U.S. citizens and their international economic activity are less complicated.

Ending deferral and disallowing deductions and foreign tax credits with respect to any project that receives any foreign MPI would be effective because it would increase the cost associated with accepting foreign MPIs. Taxes that would otherwise be deferred or not otherwise owed would be required to be paid immediately. However, all of these proposals affect the taxation of activity that occurs outside the United States, and they therefore remain subject to the numerous tax avoidance opportunities that currently exist in U.S. tax laws. As such, the extent to which these proposals will eventually become a tangible cost for the taxpayers that continue to accept foreign MPIs is unclear, rendering their effectiveness less predictable.

In addition, there are potential tax treaty concerns with these amendments. Proposal 5 has an additional obstacle in that the United States has entered over sixty-five income tax treaties, the terms of which generally require the United States to eliminate double taxation, which it currently does by offering FTCs. Therefore, the disallowance of FTCs with respect to runaway production may violate the U.S. treaty duties to eliminate double taxation even though it is clear that the United States has the right to enact legislation subsequent and contrary to the original treaty.

Proposals 3, 4, and 5 are open to potential criticism by virtue of their potential negative effect on the competitiveness of the companies attempting to do business in foreign countries. This is contrasted with the potential positive effect of increasing the United


269. Morse, supra note 157, at 565. Discussing a corporate transition tax's interaction with U.S. tax treaties:

A U.S. tax treaty partner could [be expected to] object to a corporate offshore profits transition tax if it reduced the tax revenue of the treaty partner. The incursion of a transition tax into the pre-enactment jurisdiction of a U.S. treaty partner would not necessarily present a technical problem under U.S. law. The “last in time” rule provides that a later-enacted statute trumps a U.S. tax treaty.

Id.
States' ability to compete for capital investments by retaining the production that would otherwise runaway. Many of the positive carrots that are provided by the U.S. government (deferral, mismatching of foreign and domestic income and expenses, and FTCs) are provided to enable U.S. companies to compete with foreign businesses. The concern is based on the fact that foreign companies pay lower federal taxes thereby lowering the competitors' cost of capital and increasing their competitive advantage. The positive carrots provided to U.S. businesses through the U.S. tax laws are designed to lower the U.S. companies' marginal tax rates, thereby lowering the U.S. business' cost of capital and enabling U.S. businesses to compete. However, Proposals 3, 4, and 5 would only be triggered if the U.S. taxpayer accepts tax incentives beyond the amount presently provided by U.S. tax laws. Put another way, if they do not accept those tax incentives, then the positive carrots presently available to these taxpayers remain fully intact, thus continuing to fulfill the policy goals of lowering the cost of capital and enabling them to compete in the worldwide market. The evidence of the worldwide dominance of the U.S.-based MNCs that engage in film and television production is well documented. The withdrawal of positive carrots provided to these taxpayers from foreign MPIs will result in less subsidization to these taxpayers, but it is not likely to make it impossible for them to continue to dominate the world market of film and television. However, it is an issue that would need to be monitored after the enactment of the tax law proposals.

3. Issues Applicable to Proposals 1 Through 5

The implementation of Proposals 1 through 5 will affect the decision process of taxpayers that are presently moving capital and operations abroad as to whether or not to accept foreign MPIs. If the

270. Engel, supra note 160, at 1540; Peroni, Fleming, Jr. & Shay, Curtailing Deferral, supra note 5, at 536-39.

271. Edward Herrmann and Robert McChesney, Global Media: The New Missionaries of Global Capitalism (1998); Motion Picture Ass'n of Am., The Economic Contribution of the Motion Picture and Television Industry to the United States (2011), available at http://www.mpaa.org/Resources/92be6469-1d3c-4955-b572-1d3f40f80787.pdf ("Industry registered a positive balance of trade in nearly every country in the world with $14.3 billion in exports worldwide in 2011, up 5% from 2010."); Joseph Devlin, Note, Canada and International Trade in Culture: Beyond National Interests, 14 Minn. J. Global Trade 177 (2004) ("Foreign products in Canada account for 45% of book sales, 81% of English language magazines on newsstands, 85% of film distribution revenue, and 94 to 97% of theater screen time. This market dominance by the United States troubles Canadians . . . ").
proposals achieve their intended effect of decreasing the number of projects and the aggregate amount of money spent in the countries currently offering these incentives, it is reasonable to conclude that the countries affected by these decreases will not welcome the changes. It is possible that these countries will claim that these changes are violations of international trade laws. However, the analysis of such claims is beyond the scope of this article. Even if these countries concede that the United States has the right to provide or withdraw positive carrots such as those provided in the proposals, these countries may still seek to counter these tax law revisions by applying similar withdrawals of subsidization to other industries which would result in a net loss to the United States in terms of economic utility and/or U.S. tax revenue. Ascertaining the net overall economic revenue and/or U.S. tax revenue, if any, lost from the proposals and any reactions from countries to their implementation would not be a simple task, and in any case, is also beyond the scope of this article.

Included in the implementation of the proposals would be a recommendation to eliminate the current positive carrots within I.R.C. sections 181 and 199. I.R.C. section 181 ended as of December 31, 2013, and as of the time this article was written, it is not known if it will be extended, although I.R.C. section 199 is scheduled to continue. As stated in Part III.B., a positive carrot should be reevaluated after it has been in place for a reasonable time. These tax provisions have been in place since 2004, which is a reasonable amount of time to evaluate their effect on runaway production. They have clearly not eliminated this public policy problem. Since runaway production has persisted since the enactment of these tax provisions and these laws have had a cost in the loss of U.S. tax revenue, they should be ended when the proposals provided in this article are implemented. It also has been suggested that the federal government should utilize the Commerce Clause to issue a moratorium on motion picture and television tax incentives provided by U.S. states. It is an interesting proposal but is beyond the scope of this article.

272. See supra Part IV.
VII. Conclusion

Runaway film and television production is a public policy problem that continues to drain economic activity, jobs and tax revenue from the United States. In recognition of this issue, U.S. international tax laws have been targeted for reform because they encourage and enable taxpayers to invest funds and move production overseas, which lead to the adverse results noted above. This article proposed a different assessment of the runaway film and television production problem by framing the issue within the current reform of U.S. international tax laws rather than within international trade and labor law. From this perspective, this article explained how the taxpayers involved in runaway production, namely, MNCs, are essentially subsidized twice when moving operations and production offshore. First, MNCs are subsidized by the U.S. government through U.S. tax laws that allow MNCs to engage in tax avoidance through such techniques as deferral, crossing foreign tax credits, mismatching of foreign expenses with U.S. income, and other available methods. Second, these taxpayers also receive additional money from foreign governments when they accept motion picture incentives from foreign governments when engaging in production in such foreign countries—double dipping, so to speak.

The factors that influence a decision to runaway when producing a film or television production have been identified and reviewed so as to better understand the nature of the issue. Although there are numerous factors that influence the decision to runaway, including creative factors, it is clear that foreign MPIs are a significant factor in deciding where to locate production. It is also clear that the runaway film and television problem is a tax issue based on foreign governments’ utilization of their tax laws and tax enforcement agencies to attract capital, investments and operations to their countries. As such, the use by foreign governments of their tax laws to alter the behavior of taxpayers not based in their country (in this case, to attract capital, investments and operations to their countries, i.e., runaway production) affects the U.S. tax code (specifically, the U.S. international tax laws), and therefore indicates the need for an active response by the U.S. government.

However, before proposing tax law amendments to address the problem, the remedies proposed and implemented by the U.S. federal (providing a general overview of the Commerce Clause and state tax subsidies “that encourage investment within the state”).
and state governments have been reviewed. This analysis clearly reveals that none of the implemented remedies have solved the problem of runaway production, but they have further reduced the tax revenue of the federal and state governments in a time of U.S. economic and fiscal crisis. This article reviewed the public policy tools of "carrots, sticks and sermons" in order to assist in the understanding of the remedies proposed to solve the runaway problem, and to clarify what is a proper analysis of a government's decision to discontinue a positive carrot. Eliminating a positive carrot provision in the law is not properly characterized as a negative carrot or a stick, but simply the withdrawal of government subsidization, i.e., the positive carrot.

A review of U.S. international tax policy shows that reforming U.S. tax laws to account for foreign MPIs will make U.S. tax laws more efficient and more equitable, while providing a broader U.S. tax base. Five possible reforms have been identified to achieve a dollar-for-dollar elimination of the MPIs to essentially withdraw an amount of positive carrots that the U.S. government currently provides through the U.S. tax code equal to the amount received through a foreign MPI. The most effective and efficient reforms focus on the U.S. tax return of the taxpayer that accepts foreign MPIs because many opportunities still remain in the U.S. international tax laws for taxpayers to skillfully avoid paying taxes to the U.S., which would circumvent the goals identified in this article. Although it has become clear that the interaction between the receipt of foreign MPIs and U.S. international tax laws require amendments to U.S. tax laws, the remedies proposed in this article are provided as a starting point, and further research is required to better understand the strengths and weaknesses of each proposal.